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## TABLE OF CONTENTS

The Judges of the United States Court of Appeals for the Tenth Circuit ix

Foreword xiii

Dedication to Thurgood Marshall *Pace Jefferson McConkie* 581

COMMENT

*Martin Marietta v. Lorenz*: Palpable Public Policy and the Superfluous Sixth Element 589

TENTH CIRCUIT SURVEYS

Administrative Law 625
Antitrust Law 639
Civil Procedure 665
Commercial Law 685
Constitutional Law 701
Criminal Procedure 727
Employment Law 753
Environmental Law 769
Intellectual Property 787
Lands and Natural Resources 811
Securities Law 833
Taxation 857
United States Supreme Court Review of Tenth Circuit Decisions 907

# THE JUDGES OF THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

## CHIEF JUDGE MONROE G. McKAY

Judge McKay was born in Huntsville, Utah, in 1929. He graduated from Brigham Young University in 1957 with high honors. Judge McKay then received his J.D. from the University of Chicago in 1960 and was the law clerk for Justice Jesse A. Udall of the Arizona Supreme Court for the 1960-61 term. From 1961 to 1974, Judge McKay practiced with the law firm of Lewis and Roca in Phoenix, Arizona; however, he did take a two year leave to serve as Director of the United States Peace Corps in Malawi, Africa. Judge McKay was a law professor at Brigham Young University from 1974 until 1977. In 1977, he was appointed to the United States Court of Appeals for the Tenth Circuit. Judge McKay currently resides in Provo, Utah.

## JUDGE JAMES K. LOGAN

Judge Logan was born in Quenemo, Kansas, in 1929. He received his B.A. from the University of Kansas in 1952 and was graduated *magna cum laude* from Harvard Law School in 1955. He became law clerk for United States Circuit Judge Walter Huxman and subsequently practiced with the Los Angeles law firm of Gibson, Dunn & Crutcher. Judge Logan became a professor at the University of Kansas Law School in 1957 and was selected in 1961 as Dean of that school. He served in that capacity until 1968. Since 1961, Judge Logan has been a visiting professor at Harvard Law School, the University of Texas Law School, Stanford University School of Law, and the University of Michigan Law School. He lectures at Duke University Law School. He was a special commissioner for the United States District Court for the District of Kansas from 1964 until 1967 and was a candidate for the United States Senate in 1968.

Judge Logan is a Rhodes Scholar, a member of Phi Beta Kappa, Order of the Coif, Beta Gamma Sigma, Omicron Delta Kappa, Pi Sigma Alpha, Alpha Kappa Psi, and Phi Delta Phi, and has co-authored books and numerous articles on estate planning, administration and corporate law. In 1977, he was appointed to the United States Court of Appeals for the Tenth Circuit.

## JUDGE STEPHANIE K. SEYMOUR

Judge Seymour was born in Battle Creek, Michigan in 1940. She was graduated *magna cum laude* from Smith College in 1962, and from Harvard Law School in 1965. After graduating from law school, Judge Seymour practiced law in Boston, Massachusetts from 1965 until 1966, in Tulsa, Oklahoma in 1967 and in Houston, Texas from 1968 until 1969. From 1971 to 1979 she practiced with the Tulsa law firm of Doerner, Stuart, Saunders, Daniel & Anderson. In 1979, she was appointed to the United States Court of Appeals for the Tenth Circuit.

She is a member of Phi Beta Kappa and the American and Oklahoma County Bar Associations. Additionally, Judge Seymour served as a bar examiner from 1973 through 1979; she served on the United States Judicial Conference Committee on Defender Services, 1985-87, and as chair, 1987-90.

## JUDGE JOHN P. MOORE

Judge Moore was born in Denver, Colorado in 1934. He received his B.A. from the University of Denver in 1956 and received his LL.B. from the University of Denver College of Law in 1959. Judge Moore then practiced law with the Denver firm of Carbone & Walsmith until 1962. From 1962 until 1975, he worked in the Colorado Attorney General's Office. Specifically, Judge Moore served as Assistant Attorney General from 1962 until 1967, as Deputy Attorney General from 1967 to 1972, and as Attorney General for the State of Colorado from 1972 until 1975.

In January, 1975, Judge Moore was appointed to the Bankruptcy Court of the United States District Court for the District of Colorado where he served until 1982. Judge Moore was then appointed to the United States District Court for the District of Colorado. In 1985, he was appointed to the United States Court of Appeals for the Tenth Circuit.

## JUDGE STEPHEN H. ANDERSON

Judge Anderson was born in 1932. He attended Eastern Oregon College from

1949 to 1951, and Brigham Young University from 1955 to 1956 when he graduated. Judge Anderson then attended the University of Utah College of Law where he received his LL.B. degree in 1960. He was Editor in Chief of the Utah Law Review, Order of the Coif, and Phi Kappa Phi. He then served as a trial attorney in the tax division of the United States Department of Justice until 1964.

Judge Anderson subsequently joined the law firm of Ray, Quinney & Nebeker in Salt Lake City, Utah in 1964 where he practiced until he was appointed to the United States Court of Appeals for the Tenth Circuit in 1985.

Judge Anderson has appeared as lead counsel in federal courts in seventeen states, and in the United States Supreme Court. He has served as President and Commissioner of the Utah State Bar. Additionally, Judge Anderson has been a member of the Utah Judicial Counsel and the Utah Judicial Conduct Commission, and he has served as Chairman of the Utah Law and Justice Center Committee. Judge Anderson's civic activities include lectures at the University of Utah College of Law, member of the Executive Committee of the Salt Lake Area Chamber of Commerce, and director of numerous corporations. He is a Master of the Bench, American Inn of Court Number VII.

## JUDGE DEANELL R. TACHA

Judge Tacha grew up in Scandia, Kansas. She received her B.A. in American Studies from the University of Kansas in 1968 and was a member of Mortar Board and Phi Beta Kappa. Judge Tacha then attended law school and received her J.D. from the University of Michigan in 1971.

In 1971, she was selected to be a White House Fellow. During her year as a White House Fellow, Judge Tacha was sent on official trips to southeast Asia, east and central Africa, and the European Economic Community. After her fellowship, Judge Tacha was an associate with the law firm of Hogan and Hartson in Washington, D.C. In 1973, she returned to Kansas and entered private practice in Concordia, Kansas.

Judge Tacha was appointed to the faculty of the University of Kansas Law School in 1974. In 1979, she became associate Vice Chancellor of Academic Affairs, and in 1981, she became the Vice Chancellor for Academic Affairs.

Judge Tacha was appointed to the U.S. Court of Appeals for the 10th Circuit in 1985.

## JUDGE BOBBY R. BALDOCK

Judge Baldock was born in Rocky, Oklahoma, in 1936, however, he grew up in Hagerman and Roswell, New Mexico. Judge Baldock attended the New Mexico Military Institute, where he graduated in 1956. He received his J.D. from the University of Arizona College of Law in 1960.

From 1960 until 1983, Judge Baldock practiced as a trial lawyer for the firm of Sanders, Bruin & Baldock, P.A. In 1983, he became a federal district judge in Albuquerque, New Mexico and was appointed to the United States Court of Appeals for the Tenth Circuit in 1985. In 1988, Judge Baldock received an Outstanding Judge Award from the State Bar of New Mexico.

## JUDGE WADE BRORBY

Judge Brorby was born May 23, 1934 in Omaha, Nebraska. He was raised in Upton and Newcastle, Wyoming. Judge Brorby attended the University of Wyoming and received a B.S. in Business. He graduated with a J.D. with Honor from the University of Wyoming in 1958.

Judge Brorby served in the United States Air Force from 1958 to 1961. He engaged in the private practice of law in Gillette, Wyoming from 1961 to 1988. Judge Brorby was appointed to the United States Court of Appeals for the Tenth Circuit in 1988.

Judge Brorby served on the Uniform Laws Commission and was Chairman of the Wyoming Judicial Supervisory Commission. He has served on numerous Bar committees.

## JUDGE DAVID M. EBEL

Judge Ebel was born in Wichita, Kansas in 1940 and grew up in Topeka, Kansas. He received his B.A. in economics from Northwestern University in 1962 and received his J.D. from the University of Michigan Law School in 1965, where he graduated first in his class. While at the University of Michigan Law School, he was elected to the Order of Coif, the Barrister Society, and he was Editor-in-Chief of the Michigan Law Review.

Judge Ebel then clerked for Justice Byron R. White of the United States Supreme Court during the 1965-1966 term. From 1966 until 1988, he practiced as a trial lawyer with the Denver law firm of Davis, Gra-

ham & Stubbs. In 1988, Judge Ebel was appointed to the United States Court of Appeals for the Tenth Circuit.

Judge Ebel's civic activities include teaching Corporations as an adjunct professor at the University of Denver College of Law, teaching Professionalism and Ethics at Duke University School of Law, teaching the confirmation class at the St. James Presbyterian Church and participating in numerous Bar Association activities. He has served as vice-president of the Colorado Bar Association and is a fellow of the American College of Trial Lawyers, a senior judge of the Doyle Inns of Court, and a member of the Town & Gown Society.

## SENIOR JUDGE OLIVER SETH

Judge Seth was born in 1915 and grew up in Santa Fe, New Mexico. He received his A.B. degree from Stanford University in 1937 and his LL.B. from Yale University in 1940. During World War II he served as a Major in the U.S. Army and was decorated with the Croix de Guerre. In 1962, he was appointed to the United States Court of Appeals for the Tenth Circuit. He served as Chief Judge from 1977 until 1984. In 1984, Judge Seth assumed senior status.

Judge Seth has served as director of the Santa Fe National Bank, chairman of the Legal Committee of the New Mexico Cattlegrowers' Association, Regent of the Museum of New Mexico and as a director of the Santa Fe Boy's Club.

## SENIOR JUDGE WILLIAM J. HOLLOWAY, JR.

The son of a former Oklahoma governor, Judge Holloway was born in Hugo, Oklahoma in 1923 and later moved to Oklahoma City in 1927. During World War II, he served as a First Lieutenant in the Army. After the war, Judge Holloway returned to complete his undergraduate studies at the University of Oklahoma, receiving his B.A. in 1947. Judge Holloway then attended Harvard Law School, where he graduated in 1950.

In 1951 and 1952, Judge Holloway was an attorney with the Department of Justice in Washington, D.C. He subsequently returned to Oklahoma City and entered private practice. Judge Holloway was appointed to the United States Court of Appeals for the Tenth Circuit in 1968 and became Chief Judge in 1984. He is a member of Phi Beta Kappa and Phi Gamma Delta.

## SENIOR JUDGE ROBERT H. McWILLIAMS

Judge McWilliams was born in Salina, Kansas, in 1916 and moved to Denver in 1927 where he has lived since. He received his A.B. and LL.B. degrees from the University of Denver. In 1971, he was awarded an Honorary Doctor of Law degree from the University.

During World War II, Judge McWilliams served in the United States Army and was with the Office of Strategic Services. He has served as a Deputy District Attorney and as a Colorado District Court Judge. In 1961, Judge McWilliams was elected to the Colorado Supreme Court where he served until he was appointed to the United States Court of Appeals for the Tenth Circuit in 1970. In 1984, he assumed senior status.

Judge McWilliams is a member of Phi Beta Kappa, Omicron Delta Kappa, Phi Delta Phi, and Kappa Sigma.

## SENIOR JUDGE JAMES E. BARRETT

Judge Barrett was born in Lusk, Wyoming in 1922. He is the son of the late Frank A. Barrett, who served as Wyoming's Congressman, Governor and United States Senator. Judge Barrett attended the University of Wyoming for two years prior to his service in the Army during World War II. Following the war, he attended Saint Catherine's College at Oxford University and Catholic University of America and received his LL.B. from the University of Wyoming Law School in 1949. In 1973, he received the Distinguished Alumni Award from the University of Wyoming.

Judge Barrett was in private practice in Lusk, Wyoming for eighteen years. He also served as County and Prosecuting Attorney for Niobrara County, Town Attorney for the towns of Lusk and Manville and attorney for the Niobrara County Consolidated School District. From 1967 until 1971, Judge Barrett served as Attorney General for the State of Wyoming. In 1971, he was appointed to the United States Court of Appeals for the Tenth Circuit. In 1987, he assumed senior status.

Judge Barrett was a member of the Judicial Conference Subcommittee on Federal Jurisdiction, the United States Foreign Intelligence Surveillance Court of Review, and was a trustee of Saint Joseph's Children's Home.

# FOREWORD

This Issue is dedicated to the memory of Thurgood Marshall. What a difficult thing for those of us a generation removed from his lionized years. We are indebted to the vivid essay provided by Pace Jefferson McConkie, Assistant General Counsel for the NAACP. Justice Marshall, we are reminded, accomplished much in the area now called civil rights. So much perhaps that current law students are offered specialized courses in the matter as if civil rights were a severable discipline from corporate law, for example. Of course, in practice, Marshall's legacy and the tax code are both so great that rarely could a single attorney understand both closely. But we, a generation removed, may be guilty of categorizing Marshall's role on the Court too quickly. We lack the cultural experience of vast sweeping change as Marshall's cohort incited in education, voting, housing, employment, transportation, public accommodation, etc. We sometimes accept the boundaries others place on civil rights.

Justice Marshall hardly lacked vision beyond the change he helped accomplish in the 1950s and 1960s. While he is most often associated with school desegregation, affirmative action, and rights of the accused, a review of his decisions arising from the Tenth Circuit reveal a rarely examined concern with Native American Rights. In his first review of a Tenth Circuit decision, Marshall displayed characteristic concern with criminal procedure. *Barber v. Page*,[1] a 1968 decision, declared that before the transcript of a co-perpetrator's preliminary hearing testimony can be used against the defendant, the right of confrontation requires that prosecutorial authorities make a good faith effort to obtain the presence of the witness at trial.

During the 1970s and 1980s, however, Marshall handed down a series of important decisions as to the sovereignty of tribal affairs. In *Santa Clara Pueblo v. Martinez*,[2] the Court rejected an attempt to expand federal review of tribal court decisions beyond the limited availability of writs of habeas corpus, preserving the authority of tribal courts to resolve issues based on tribal tradition and custom. In *Merrion v. Jicarilla Apache Tribe*,[3] the Court upheld the Tribe's power to assess a severance tax on oil and gas production on reservation land as an essential attribute of Native American sovereignty, and a necessary instrument of self-government and territorial management. In *New Mexico v. Mescalero Apache Tribe*,[4] state hunting and fishing regulations of non-tribal members on reservation land conflicted with tribal ordinances regulating both members and nonmembers. The Court concluded that New Mexico's regulations

1. 390 U.S. 719 (1968).
2. 436 U.S. 49 (1978).
3. 455 U.S. 130 (1981).
4. 462 U.S. 324 (1983).

were preempted by both the Tribe's authority to regulate the use of its resources and the federal objective of encouraging tribal self-government and economic development.[5]

These decisions reveal a broader view of Justice Marshall's activism, or rather, his wise restraint. Many of us now in law school have never lived without Justice Marshall's influence on the Supreme Court, much less understand the breadth of knowledge exerted in his twenty-four years of service there. We may see his generation as serving an agenda unrelated from our economic doubts in the 1990s. But if Thurgood Marshall was, as Pace McConkie's Dedication persuades, a man of simple justice, his work did not stop with single causes. His memory, in epitome, holds every relevance for young lawyers today.

## About This Issue

With the emergence of several looseleaf services focused on Tenth Circuit decisions, the broad ranging attempt to report on every decision that has characterized previous Tenth Circuit Survey Issues of the *University of Denver Law Review* has become less useful. Returning to its origins, the current Issue focuses on analysis of Tenth Circuit opinion in a narrow group of federal topics. When the *Review* began its Survey Issues nearly 20 years ago, our objectives were to critically comment on significant court of appeals decisions and to inform federal practitioners in a limited number of areas. Now Senior Judge McWilliams wrote in a 1977 Foreword: "Of course at the heart of any successful survey of this type is the scholarship and objectivity of the reviewer. As might be well imagined, the members of the Tenth Circuit look forward to the annual survey with great interest, and perhaps a slight degree of trepidation!"[6] The following thirteen Surveys take an admirable first step toward restoring this spirit.

The Issue begins with a student-written piece on the Colorado Supreme Court decision in *Martin Marietta v. Lorenz.* With the court's unusual formulation of public policy protection for at-will employees, the Comment should easily be considered a definitive resource for attorneys preparing for employment litigation in this area. The *Review* plans to continue its narrower analysis in future Tenth Circuit Survey Issues, hopefully to the advantage of federal practitioners and to the benefit of the court of appeals. We extend our special thanks to Survey authors and members of the *Review* who endured the additional burden of a campaigning Issue editor.

*Christopher Payne*

5. *Id.* at 338-40.
6. Judge Robert H. McWilliams, *Foreword*, 54 DENV. U.L. REV. 1-2 (1977).

# DEDICATION TO THURGOOD MARSHALL

PACE JEFFERSON MCCONKIE*

Volumes have been written on the life and works of Thurgood Marshall. Still, his twenty-four year tenure on the United States Supreme Court, his courageous and remarkable career with the National Association for the Advancement of Colored People and the NAACP Legal Defense and Educational Fund, Inc., and his private commitment to family and human dignity far exceed whatever has been penned by deeply grateful admirers and objective observers alike. He was a giant of a man in both stature and character. His works fall nothing short of heroic. In the end, however, his accomplishments stand for one solid conclusion - simple justice.

It is fitting that this issue of the *Denver University Law Review* is dedicated to one whose influence upon the developments of federal law has already proved to be lasting and profound. The term "developments" is carefully chosen, for ours is a legal system of growth, maturation and improvement. Understanding this, Thurgood Marshall decided early to be a social engineer rather than merely a lawyer and he used the law itself to develop and gravitate a legal society in the direction it was required, by Constitutional mandate, to go. In turn, he did "not believe that the meaning of the Constitution was forever 'fixed' at the Philadelphia Convention."[1] Instead he looked to the Constitution's "promising evolution through 200 years of history" and recognized that the founders who gathered in Philadelphia in 1787 "could not have imagined, nor would they have accepted, that the document they were drafting would one day be construed by a Supreme Court to which had been appointed a woman and the descendant of an African slave."[2]

Since his retirement from the high Court in 1991, and again following his death on January 24, 1993, many have paid tribute to Justice Marshall. These tributes, all eloquent and appropriate, have come in various forms and from a diversity of sources including those at the highest levels of government. Perhaps none, however, can match in simplicity and dignity the tribute paid by a young teenage girl who, on a historic September morning in Little Rock, Arkansas, stood alone against the Arkansas National Guard and a beastly cruel white mob outside Central High School in 1957.

Elizabeth Eckford, one of the black students known as the "Little Rock Nine" chosen to integrate Central High, had excitedly pressed the

* Ass't General Counsel, NAACP; B.A. University of Utah, 1984; J.D. University of Arkansas at Little Rock, 1987.

1. Thurgood Marshall, *Reflections on the Bicentennial of the United States Constitution*, 101 HARV. L. REV. 1, 2 (1987).

2. *Id.* at 5.

black and white dress she made for the first day of school. Unaware that the other eight children were gathered at the home of Ms. Daisy Bates, president of the Arkansas State Conference of NAACP Branches, for a police escort to Central, Elizabeth set off for school alone. Refusing to be turned away by the large crowd which had gathered on the school grounds, Elizabeth walked on towards the guardsmen in hopes of both protection and admission to the school. With steely bayonets raised, the guardsmen only served to turn her back, unprotected, to the jeering mob.

As the crowd closed in around Elizabeth, she endured indignities and hurt unimaginable to most of us but unforgettably familiar to some. She was spat upon and scorned. Unrelenting racial slurs were hurled against her. Cries of "lynch her," "nigger bitch" and "drag her over to this tree" numbed her until she could only sit down in despair on a bus stop bench, tears streaming down her cheeks from under her sunglasses. Finally, she was whisked away by a Pulitzer prize winning editor of *The New York Times* and a compassionate woman crying shame at the crowd. Daisy Bates later wrote:

> In the ensuing weeks Elizabeth took part in all the activities of the nine — press conferences, attendance at court, studying with professors at nearby Philander Smith College. She was present, that is, but never really a part of things. The hurt had been too deep.
> On the two nights she stayed at my home I was awakened by the screams in her sleep, as she relived in her dreams the terrifying mob scenes at Central. The only times Elizabeth showed real excitement were when Thurgood Marshall met the children and explained the meaning of what had happened in court. As he talked, she would listen raptly, a faint smile on her face. It was obvious he was her hero.[3]

Thurgood Marshall was a hero to many, but especially to those such as Elizabeth Eckford and the countless "freedom fighters," young and old, who have served in the trenches of this nation's civil rights battles. In this regard, a former law clerk and personal friend eulogized Justice Marshall in these words:

> From poor sharecroppers in Mississippi who sought the right to vote, to frightened parents in Little Rock who asked only for the right to a decent education for their children, the clarion call of hope sounded when Americans oppressed by racial determination heard the words — "The lawyer is coming."
> Justice Marshall's arrival at the Supreme Court in 1967 changed more than the complexion of the men sitting around the Friday conference table. He changed the nature and focus of the debate — both because he was at the table and because he spoke from the heart for the humble people who could not

3. DAISY BATES, THE LONG SHADOW OF LITTLE ROCK 72 (1962 ed.).

be there to speak for themselves.[4]

Though twenty-four years an associate justice of the United States Supreme Court, two years the Solicitor General of the United States and four years a judge on the U.S. Court of Appeals for the Second Circuit, Thurgood Marshall's most significant triumphs came as a NAACP lawyer. The landmark opinion in *Brown v. Board of Education of Topeka*[5] culminated years of NAACP litigation to eradicate the separate but equal doctrine of *Plessy v. Ferguson*,[6] with its massive inequalities, and abolished this country's segregated and discriminatory system of public education at all levels.

In the mid 1930s, under the direction of his legal mentor and former law professor, Charles Hamilton Houston, Marshall and the NAACP represented Donald G. Murray, a black graduate from Amherst College, in his successful suit to gain admission to the University of Maryland Law School, the same institution which had earlier denied a legal education to Marshall solely because of his race.[7] Two years later, Houston and Marshall challenged a Missouri Supreme Court opinion which held that because law schools in surrounding states accepted black students, a black citizen of Missouri was not denied his constitutional rights to equal protection under the law upon exclusion from the state supported law school in Missouri. In *Missouri ex rel. Gaines v. Canada*,[8] the U.S. Supreme Court ruled that black students constitutionally could not be put to the burden of having to leave the state to attend graduate or professional schools and that Missouri could not furnish white students educational opportunities and deny the same to black students solely upon the grounds of race or color. During Houston's oral argument of this case, Justice James McReynolds turned his back on the NAACP attorney and stared at the wall of the courtroom.

In 1946, Ada Lois Sipuel was denied admission to the University of Oklahoma Law School because of her race. Thurgood Marshall led the NAACP efforts to secure her a legal education afforded by a state institution.[9] Today, Ms. Sipuel sits as a distinguished member of that institution's Board of Regents. Marshall continued with such cases as *Sweatt v. Painter*[10] outlawing segregation by way of a separate and unaccredited law school for blacks in Texas, emphasizing equality in the educational opportunities offered white and black law students by the state; *McLaurin v. Oklahoma State Regents for Higher Education*[11] banning segregation and differential treatment at the graduate school level, where G.W. McLaurin had been "required to sit apart at . . . designated desk[s] in an

4. Karen Hastie Williams, *Inspired Those He Touched . . . Every American*, WASH. POST, Jan. 29, 1993, at A15.

5. 347 U.S. 483 (1954).

6. 163 U.S. 537 (1896), *overruled by* Brown v. Board of Educ., 347 U.S. 483 (1954).

7. *Pearson v. Murray*, 182 A. 590 (Md. 1936).

8. 305 U.S. 337 (1938).

9. *Sipuel v. Board of Regents of Univ. of Okla.*, 332 U.S. 631 (1948).

10. 339 U.S. 629 (1950).

11. 339 U.S. 637, 640 (1950).

anteroom adjoining the classroom . . . [and] on the mezzanine floor of the library . . . and to sit at a designated table and to eat at a different time from the other students in the school cafeteria"; and *Florida ex rel. Hawkins v. Board of Control*[12] where Virgil Hawkins was entitled to prompt admission to graduate professional school under the rules and regulations applicable to other qualified candidates.

By 1950, Thurgood Marshall and his cadre of NAACP lawyers had logistically turned their full attention to state-imposed racism and segregation at the elementary and secondary levels of public education. Of the five cases later to become known as *Brown v. Board of Education*, four were handled and sponsored by the NAACP (the South Carolina, Topeka, Ka., Virginia, and Delaware cases). The fifth case, out of the District of Columbia, was financed by a local organization known as the Consolidated Parents, Inc. Its attorneys, however, were all members of the NAACP legal committee. After years of meticulous planning, strategy and litigation, the NAACP had finally engineered its cases to the crushing defeat of the *Plessy* doctrine.

The significance of Thurgood Marshall's triumph in *Brown* cannot be overemphasized. It shook the very moral fibre of this country and its public institutions. It crumbled the foundation of segregation. It finally established as the supreme law of the land that in the field of public education, the doctrine of separate but equal has no place, that separate is inherently unequal, and that the segregation complained of deprived the black plaintiffs and those similarly situated of the equal protection of the laws guaranteed by the Fourteenth Amendment. It established the constitutional basis for the democratic ideal of equal opportunity for all Americans regardless of race or color and guaranteed protection from the highest court in the land in the pursuit of those opportunities and rights.

On May 22-23, 1954, NAACP representatives met with Thurgood Marshall in Atlanta, Georgia to develop a legal program "to meet the vital and urgent issues arising out of the historic United States Supreme Court decision of May 17 banning segregation in public schools."[13] The NAACP there rededicated itself to the removal of all racial segregation in public education "without compromise of principle" and stated that "[t]he total resources of the NAACP will be made available to facilitate this great project of ending the artificial separation of America's children on the irrelevant basis of race and color."[14] From that point in time, the NAACP legal program swept through the officially segregated South with extensive litigation in that region's school districts. Its attention was then turned northward and westward with successful and far reaching litigation in cities such as Dayton and Columbus, Ohio and Detroit, Michigan.

The impact of *Brown* extended well beyond the field of public edu-

12. 350 U.S. 413 (1956).
13. NAACP, ATLANTA DECLARATION (1954), *reprinted in*, 86 THE CRISIS 198 (1979).
14. *Id.*

cation. For the first time, the long and unremitting struggle for civil rights had reached the possibility of eliminating "separate but equal" from all phases of society; including voting, reapportionment, housing, employment, transportation and public accommodations. Certainly, the aftermath of *Brown* also led to the major Civil Rights, Voting Rights, Equal Employment and Equal Housing statutes of the 1960s.

To link these civil rights milestones to the legacy of Thurgood Marshall and *Brown* is entirely appropriate. After years of successful civil rights litigation not limited to public education alone, *Brown* served to open the floodgates. Thurgood Marshall's other significant victories included, among others: *Smith v. Allwright*,[15] which invalidated the voting practice of "white primaries" and gave blacks the right to vote in Democratic party primary elections; *Morgan v. Virginia*,[16] outlawing segregation in interstate travel; and the combined cases of *McGhee v. Sipes* and *Shelley v. Kraemer*,[17] declaring racially restrictive covenants in housing unconstitutional. Another eulogy delivered at Justice Marshall's funeral service effectively reminds us of how he influenced and shaped the whole of America's society. Looking directly at the President of the United States who was seated on the front row, William T. Coleman, Jr. asked whether a "son of Arkansas" would be in that position today if Thurgood Marshall had not been successful in his efforts to make southern institutions equal:

> Please do not think us ingracious when we wonder how a son of Arkansas would be here if Thurgood Marshall in that hot summer of 1958 had lost, not won, the Little Rock school case? Would you be here if Marshall had lost, not won, the important voting rights cases? Could there be a Cabinet reflective of the American people if Marshall had lost *Brown v. Board of Education* or the voting rights case?[18]

On the Supreme Court, Justice Marshall was no less distinguished. This is particularly true with regard to his commitment to the rights of the individual and the especial protection of the rights of minorities, women, the poor, the powerless and the disadvantaged. On various issues, he wrote over 300 majority opinions for the Court and never relented in the face of apparent retrenchment by the Court of the civil rights agenda. "This retrenchment . . . caused Justice Marshall's dissents to escalate from a total of 19 in his first five years, while Earl Warren was Chief Justice, to a total of 225 in the [first] five years [after] William Rehnquist became Chief Justice."[19]

Some of Justice Marshall's key decisions include *Amalgamated Food*

15. 321 U.S. 649 (1944).

16. 328 U.S. 373 (1946).

17. 334 U.S. 1 (1948).

18. Joan Biskupie, *One 'Whose Career Made Us Dream Large Dreams,'* WASH. POST, Jan. 29, 1993, at A1 (eulogy delivered by William T. Coleman, Jr.).

19. A. Leon Higginbotham, Jr., *A Tribute to Justice Thurgood Marshall*, 105 HARV. L. REV. 55, 65 n.55 (1991).

*Employees Union Local 540 v. Logan Valley Plaza*,[20] where he wrote for the majority to secure the rights of union organizers to picket in front of a supermarket; *Stanley v. Georgia*,[21] where the Court recognized the state's broad power to regulate obscenity but refused to extend it to the mere possession by the individual in the privacy of his own home; *Gregg v. Georgia*,[22] dissenting from the Court's reinstatement of the death penalty following its four year ban after *Furman v. Georgia*;[23] *Regents of the University of California v. Bakke*,[24] writing separately to applaud the Court's judgment that a university may consider race as a factor in its admission process but expressing dissent and irony that, after hundreds of years of class-based discrimination against blacks, the Court was unwilling to hold that a class-based remedy for that discrimination is permissible; and *Rostker v. Goldberg* ,[25] dissenting from the decision that upheld the discriminating rule requiring men, but not women, to register for the draft, thereby excluding women from a fundamental civic obligation.

Perhaps most representative of Justice Marshall's career on the bench and at the bar is his dissent in *Milliken v. Bradley*.[26] The Court there overturned a ruling that required suburban school districts to participate in a cross-district plan to desegregate the Detroit public schools that were 80% to 90% black. In essence, the Court retrenched from the "all out," "root and branch" desegregation remedial standard of *Brown* and its progeny to instigate a "nature and extent of the violation determines the scope of the remedy" principle. The result, however, would leave many schools segregated. Justice Marshall wrote:

> Desegregation is not and was never expected to be an easy task. Racial attitudes ingrained in our Nation's childhood and adolescence are not quickly thrown aside in its middle years. But just as the inconvenience of some cannot be allowed to stand in the way of the rights of others, so public opposition, no matter how strident, cannot be permitted to divert this Court from the enforcement of the constitutional principles at issue in this case. Todays holding, I fear, is more a reflection of a perceived public mood that we have gone far enough in enforcing the Constitution's guarantee of equal justice than it is the product of neutral principles of law. In the short run, it may seem to be the easier course to allow our great metropolitan areas to be divided up each into two cities—one white, the other black—but it is a course, I predict, our people will ultimately regret. I dissent.[27]

Americans of all races and from all walks of life owe a great debt to Thurgood Marshall. His vision, courage and competence established a

20. 391 U.S. 308 (1968), *overruled by* Hudgens v. NLRB, 424 U.S. 507 (1976).
21. 394 U.S. 557 (1969).
22. 428 U.S. 153 (1976).
23. 408 U.S. 238 (1972).
24. 438 U.S. 265 (1978).
25. 453 U.S. 57 (1981).
26. 418 U.S. 717 (1974).
27. *Id.* at 814-15.

legacy in law and justice that touches us all. His legacy will continue, but only as long as those of us who cherish the Constitution and its guiding principles recognize the end for which it was established—equal justice under law—and use the power of the law as effectively and judiciously as he did to ensure that this "end" is a reality for those who have long been denied the dignity of both equality and justice.

# *MARTIN MARIETTA V. LORENZ*: PALPABLE PUBLIC POLICY AND THE SUPERFLUOUS SIXTH ELEMENT

## I. INTRODUCTION

The Colorado Supreme Court, in *Martin Marietta v. Lorenz*,[1] recognized on first impression a public policy exception in tort to the at-will employment doctrine.[2] "[I]n keeping with the majority of jurisdictions," and "within the framework" of prior Colorado case law,[3] the court adopted and extended the standard to establish a *prima facie* case of wrongful discharge under the public policy exception as originally set out by the Colorado Court of Appeals in *Cronk v. Intermountain Rural Electric Association*.[4] *Cronk I* stated that an employee must prove a five step *prima facie* case to qualify for an exception to the at-will employment doctrine: (1) the employee refused to perform an action; (2) ordered by the employer; (3) which would violate a specific statute; whose terms are more than a broad general statement of policy; and (5) the employee's termination resulted from the refusal to perform such action.[5] Adding to this *Cronk I* standard, the *Lorenz* court required an additional, sixth element to establish a *prima facie* case—evidence showing that the employer was aware, or reasonably should have been aware, that the employee's refusal to perform the employer's directive was based on the employee's reasonable belief that the employer's directive was illegal, contrary to clear statutory policy relating to the employee's duty as a citizen, or violative of the employee's legal rights or privileges as a worker.[6] By adding this new employer knowledge element, the *Lorenz* court ventures into a virtual frontier. No authority is cited by the court

1. 823 P.2d 100 (Colo. 1992) (en banc).

2. *Lorenz*, 823 P.2d at 108.

3. *Id.*

4. 765 P.2d 619, 622 (Colo. Ct. App. 1988), *cert. denied* (*Cronk I*), *appeal after remand*, 140 L.R.R.M. (BNA) 2149 (Colo. Ct. App. April 2, 1992), *cert. denied* (*Cronk II*).

5. *Cronk I*, 765 P.2d at 622. The *Cronk I* court interpreted Farmer v. Central Bancorporation, 761 P.2d 220 (Colo. Ct. App. 1988), which set a two-step test for exception to the at-will employment doctrine, restricted to the facts of the case. The *Farmer* court held that to gain employee protection of the public policy exception to the at-will employment doctrine, the employee must establish that (1) the refusal to carry out the employer's directive would constitute a statutory violation; and (2) the employee's discharge was a result of the refusal to violate the statute. *Farmer*, 761 P.2d at 221.

6. *Lorenz*, 823 P.2d at 109. Under the new *prima facie* standard set out by the court, the employee must prove by a preponderance of the evidence that: (1) the employer directed the employee to perform an illegal act; (2) as part of the employee's work related duties; or (3) prohibited the employee from performing a public duty, privilege or right; (4) the employer's directive would violate a specific statute relating to the health, safety, or welfare or undermine clearly expressed public policy relating to the employee's rights or privileges as a citizen or worker; (5) the employee was terminated as the result of refusing to perform the act directed by the employer; and (6) the employer was aware, or reasonably should have been aware, that the employee's refusal was based on the employee's reasonable belief that the action ordered by the employer was violative of any of the above circumstances. *Id.*

for this proposition, as noted by the dissent.[7] Currently there is no clear, accurate way to predict how the Colorado courts will apply this new standard at the trial level,[8] or how the parties will satisfy or defend against this additional employer knowledge element.[9]

This Comment will describe some of the historical legal background of the at-will employment doctrine, case law leading to this decision, the court's rationale in recognizing the public policy exception, an analysis of terminology, and an examination of the employer knowledge element as set forth in *Lorenz*. *Lorenz* is also compared with other jurisdictions' causation elements in similar fact patterns, as well as compared with current federal and state legislative trends.

This Comment concludes that the employer knowledge element, as an element of causation, is implicit within nearly all *prima facie* cases of retaliatory discharge. An employee alleging retaliatory discharge cannot prove causation without the inference of employer knowledge because an employer must have a *reason* to retaliate. The employer who retaliates must know what event concerning the employee's conduct is the source of the employer's desire to "get even." Thus, if retaliation is proved in connection with the adverse employment action taken against the employee, the employer knowledge element is implicitly proven as well. To require separate proof on the employer's knowledge of the employee's state of mind concerning the employee's act or refusal to act is superfluous once retaliation itself has been proven.

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7. *Id.* at 118 n.1 (Erickson, J., dissenting). Justice Erickson states in part, "Today's test includes a sixth prong that *substantially* changes *Cronk [I]*. . . . Indeed, the majority cites *no authority* for requiring employer knowledge of an employee's reasonable belief that a refused order was illegal." *Id.* (emphasis added). Authority does, in fact, exist for the majority's proposition. *Infra* notes 161-177 and accompanying text.

8. The trial date on remand has been set for January 24, 1994. Statement of Maxine Foster, Denver District Court Division Clerk for Courtroom 19 (April 16, 1993) (No. 81 CV 6488). Twelve years after the suit was first filed, and eighteen years after Lorenz's discharge, the parties will start over again with a new trial in accordance with the *Lorenz* holding.

9. Because the *Lorenz* rule will apply retroactively, potential recovery still exists for Lorenz. David J. Jung and Richard Harkness, in *The Facts of Wrongful Discharge*, 4 LAB. LAW. 257 (1988), discuss and criticize various surveys of jury awards in wrongful discharge cases. They note that averages are dubious at best because of their inherent sensitivity to unusually high or low awards. *Id.* at 259. Based on Jung and Harkness' review of published cases, California employees prevail in only 45% of judicially resolved cases with estimated average awards at over $200,000. *Id.* at 260-61. Their research demonstrates that the *type* of wrongful discharge affects jury awards. Of the three types of wrongful discharges recognized in California as exceptions to the at-will doctrine (retaliatory, breach of implied-in-fact contract, and violation of the implied law of good faith and fair dealing in contracts), retaliatory and bad faith cases average much higher awards than do breach of implied-in-fact contract cases. Intentional infliction of emotional distress cases, a fourth cause of action in some jurisdictions also receive lower jury awards. *Id.* at 262-64.

For other examples documenting large jury verdicts see Rulon-Miller v. International Business Mach. Corp., 162 Cal. App. 3d 241 (1984) ($100,000 compensatory and $200,000 punitive damages award relating to a wrongful termination upheld); James N. Adler & Mark Daniels, *Managing the Whistleblowing Employee*, 8 LAB. LAW. 19, 19-20 (1992) (noting multi-million dollar jury verdicts for damages in several wrongful discharge cases); James W. Hubbell, *Retaliatory Discharge and the Economics of Deterrence*, 60 U. COLO. L. REV. 91, 113 n.80 (1989) (noting that, in one survey, employees were victorious 60-90% of the time with verdicts averaging $400,000).

## II. LEGAL BACKGROUND

### A. *Historical Overview*

Early English common law recognized that a general hiring of a servant, in the absence of a contrary agreement, was presumed to be a one-year hiring, and no master could "put away his servant" during that year without "reasonable cause."[10] Early colonial American law generally followed the English common law regarding employment contracts, but America "did not apply criminal law to employee breaches of contract."[11] By the late 19th century, New England textile industry employers were able to discharge employees without notice, yet still demand notice from the employees when they quit.[12] After 1877, the American courts adopted a doctrine known as "Wood's Rule" of at-will employment which, in the absence of a specific duration of employment, allowed either the employer or the employee to terminate the employment contract at any time for good cause, bad cause or no cause.[13] Controversy exists over whether the cases cited by Wood[14] ac-

10. Cornelius J. Peck, *Penetrating Doctrinal Camouflage: Understanding the Development of the Law of Wrongful Discharge*, 66 WASH. L. REV. 719, 721 (1991) (*quoting* 1 W. BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 425-26 (21st ed. 1847)) [hereinafter Peck, *Penetrating Doctrinal Camouflage*]. The Statute of Labourers provided this language attempting to protect employees hired for menial labor from termination without "reasonable cause," or without "reasonable notice," while also requiring certain classes of persons to accept employment. Clyde W. Summers, *Individual Protection Against Unjust Dismissal: Time For a Statute*, 62 VA. L. REV. 481, 485 (1976). *See also* Lynn D. Feiger, *"Employment At Will" and the Discharged Employee in Colorado*, 12 COLO. LAW. 733 (1983). Even after the Statute of Labourers was repealed, English common law continued to presume employment contracts as one-year terms, and by the 19th century the general rule was that "unless otherwise explicitly agreed, employment could be terminated only after a notice period determined by the custom in the trade, and if there were no custom, only after a reasonable notice, unless cause existed[.]" Summers, *supra* at 485; Fieger, *supra* at 733. For more detailed information on the Statute of Labourers, see Cheryl S. Massingale, *At-Will Employment: Going, Going . . .*, 24 U. RICH. L. REV. 187, 188 & n.5 (1990).

Charles Smith states that when no express or implied duration of time exists in a contract of hiring (in England), the hiring is considered a general hiring for one year which extends not only to servants, but also domestics and clerks. CHARLES M. SMITH, A TREATISE ON THE LAW OF MASTER AND SERVANT *84-*85. A contract must exist for the rule to apply, and a contract will not be presumed when circumstances show that a pauper has come "to live with their relatives or others out of charity, or where the agreement was for cohabitation and not merely for service." *Id.* at *85-*86. Additionally, the presumption of a one-year hiring could be "greatly strengthened" by trade, business or occupational custom. *Id.* at *86. In the proper circumstances, an employee wrongfully dismissed before the end of the one-year term could seek a recovery of damages in the amount of wages he would have earned had he been allowed to serve to the end of the year. *Id.* at *91. If, however, the servant wrongfully quit his master's service, then the servant forfeited all claim to wages for the remainder of that year. *Id.* at *92.

11. Peck, *Penetrating Doctrinal Camouflage*, *supra* note 10, at 721.

12. *Id.*

13. H. G. WOOD, A TREATISE ON THE LAW OF MASTER AND SERVANT § 133, at 272-77 (2d ed. 1886). According to Wood, when the term of service in a contract of hiring is left discretionary in any way with either party, then either may "put an end thereto at any time." *Id.* at 272-73. Wood also explained that an annual rate of pay does not imply a definite term of employment where a term of employment is not otherwise stated, but merely a contract to pay a certain rate for services actually rendered. *Id.* § 136, at 284-85. Wood recognized that exceptions exist to the at-will employment doctrine, such as when the employer requires the employee to perform illegal or immoral services, or acts that would damage the employee's reputation. *Id.* § 148, at 297-98.

tually support his "at-will" theory.[15] Nevertheless, many American courts continued to follow the general doctrine of Wood's Rule in the final years of the 20th century.[16]

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14. *Id.* § 133, at 272-73.

15. Alfred W. Blumrosen, *Employer Discipline: United States Report*, 18 RUTGERS L. REV. 428, 432 (1964) (describing how the rigorous and restrictive application of Wood's rule spread rapidly throughout the country); Cornelius J. Peck, *Unjust Discharges From Employment: A Necessary Change in the Law*, 40 OHIO ST. L.J. 1, 2 (1979) [hereinafter Peck, *Unjust Discharges*] (noting Blumrosen's demonstration that American courts followed this "erroneous" statement of law); Peck, *Penetrating Doctrinal Camouflage*, *supra* note 10, at 722 (in accord with his earlier article, but also crediting Field's New York Civil Code and 1 CAL. CIV. CODE § 1999 (1872) with contributing to Wood's proposition in codified form); Summers, *supra* note 10, (none of Wood's four cases used as authority supported his theory); Note, *Protecting Employees At Will Against Wrongful Discharge: The Public Policy Exception*, 96 HARV. L. REV. 1931 (1983) (Wood's rule was unsupported by authorities upon which the author relied, but was ideally suited to the United States' rapidly industrializing economy); *see also* James W. Hubbell, *Retaliatory Discharge and the Economics of Deterrence*, 60 U. COLO. L. REV. 91 (1989) (arguing from an economics viewpoint that the at-will doctrine promotes allocative efficiency in the free flow of labor, but employers should be held accountable when the at-will doctrine is used to coerce employees to commit perjury or a tort); Peter S. Partee, *Reversing the Presumption of Employment At Will*, 44 VAND. L. REV. 689 (1991); Jill S. Goldsmith, Comment, 1986 ARIZ. ST. L.J. 161, 164 (1986); Note, *Implied Contract Rights to Job Security*, 26 STAN. L. REV. 335, 341-45 (1974).

Some commentators have endorsed Wood's rule as having been properly supported. *See generally* Mayer G. Freed & Daniel D. Polsby, *The Doubtful Provenance of "Wood's Rule" Revisited*, 22 ARIZ. ST. L.J. 551 (1990). Others have endorsed the at-will employment doctrine. *See* Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947 (1984); Hubbell, *supra;* Larry S. Larson, *Why We Should Not Abandon the Presumption That Employment is Terminable At-Will*, 23 IDAHO L. REV. 219 (1986-87); Richard W. Power, *A Defense of the Employment At Will Rule*, 27 ST. LOUIS U. L.J. 881 (1983).

For a sampling of the frequently cited commentaries criticizing the at-will doctrine, see Lawrence E. Blades, *Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 COLUM. L. REV. 1404 (1967); Blumrosen, *supra;* Donald H.J. Hermann & Yvonne S. Sor, *Property Rights in One's Job: The Case for Limiting Employment-at-Will*, 24 ARIZ. L. REV. 763 (1982); Donald G. Kempf, Jr. & Roger L. Taylor, *Wrongful Discharge: Historical Evolution, Current Developments and a Proposed Legislative Solution*, 28 SAN DIEGO L. REV. 117 (1991); Massingale, *supra* note 10; Peck, *Unjust Discharges*, *supra*; Peck, *Penetrating Doctrinal Camouflage*, *supra* note 10; Theodore J. St. Antoine, *A Seed Germinates: Unjust Discharge Reform Heads Toward Full Flower*, 67 NEB. L. REV. 56 (1988); Clyde W. Summers, *Labor Law as the Century Turns: A Changing of the Guard*, 67 NEB. L. REV. 7 (1988); Summers, *supra*, note 10; Paul H. Tobias, *Current Trends in Employment Dismissal Law: The Plaintiff's Perspective*, 67 NEB. L. REV. 178 (1988); Note, *Employer Opportunism and the Need for a Just Cause Standard*, 103 HARV. L. REV. 510 (1989); Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, 93 HARV. L. REV. 1816 (1980); Note, *Contracts—Termination of Employment at Will—Public Policy May Modify Employer's Right to Discharge*, 14 RUTGERS L. REV. 624 (1960).

In contrast to the common law at-will doctrine, South Dakota statutes provide that the length of time which an employer and employee adopt for the estimation of wages is relevant to a determination of the term of employment. S.D. CODIFIED LAWS ANN. §§ 60-1-3 to -5 (Supp. 1992). In the absence of an agreement or custom as to rate of pay, an employee is presumed to be hired by the month at a monthly rate of reasonable wages, to be paid when the service is performed. *Id.* § 60-1-4. If the parties continue the employment relationship after the expiration of an agreement, they are presumed to have renewed the agreement for the same wages and term of service. *Id.* § 60-1-5. This sets South Dakota apart from all other U.S. jurisdictions by statutorily recognizing circumstances in the overall contractual relationship between employer and employee as factors to weigh against the strict application of the at-will doctrine. Montana, Puerto Rico and the Virgin Islands also provide statutory exceptions to at-will employment, having enacted specific wrongful discharge legislation which supersedes common law claims. *See infra* notes 195-201 and accompanying text.

16. RESTATEMENT (SECOND) OF AGENCY § 442 (1958):

B. *Precedent in Other States*

In 1959, California became the first jurisdiction to expressly recognize the public policy exception to at-will employment in *Petermann v. International Brotherhood of Teamsters Local 396.*[17] In *Petermann*, an employee of the union, was instructed by the union's secretary-treasurer to make untrue statements, under oath, to a California legislative committee. Instead, the employee truthfully answered all questions. He was discharged by the union the following day.[18] The court first acknowledged that the plaintiff was an at-will employee subject to termination for any reason at the will of either party. The court stated, however, that such an at-will contract may be limited either by statute or by considerations of public policy.[19] The court observed that the term "public policy" was imprecise, and noted that few cases could arise where the expression is not disputed.[20] The court reasoned that in order to "fully

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[*Period of Employment*] Unless otherwise agreed, mutual promises by principal and agent to employ and to serve create obligations to employ and to serve which are terminable upon notice by either party; if neither party terminates the employment, it may terminate by lapse of time or by supervening events.

*Id.* § 442. Comment b states that salary paid proportionally to units of time does not, of itself, indicate that the parties have agreed that the employment is to continue for the stated unit of time[,]. . . [but] merely indicates the rate at which the salary . . . is to be paid, and either party is privileged to terminate the relationship at any time unless further facts exist.

*Id.* at cmt. b. The RESTATEMENT also recognizes that when the principal directs the agent contrary to an interest which he is privileged to protect, the agent's remedy is not to violate the principal's orders but to obtain relief for breach of the principal's implied agreement not to give unreasonable directions. *Id.* § 385 cmt. d and illus. 4 (1958). Further, the RESTATEMENT provides that the agent has no duty to commit a tort or a minor crime at the command of the principal, and that such a contract is illegal. *Id.* § 418, cmt. a. Finally, the RESTATEMENT repeats the content of § 385, stating that a servant may be justified in disobeying an unreasonable rule or order which the master is not privileged to impose on him. *Id.* § 526, cmt. c. Thus, the RESTATEMENT both supports Wood's Rule and at the same time recognizes that certain exceptions exist when the principal instructs the agent to commit a tort or illegal act.

17. 344 P.2d 25 (Cal. Ct. App. 1959). *See* Peck, *Penetrating Doctrinal Camouflage*, *supra* note 10 at 723; Note, *Protecting At Will Employees Against Wrongful Discharge: The Duty to Terminate Only in Good Faith*, *supra* note 15, at 1822.

18. *Petermann*, 344 P.2d at 26.

19. *Id.* at 27.

20. *Id.* "Public policy" indeed escapes precise definition. For example, one interesting and poignant definition of "public policy" is: "[a] will-o'-the-wisp of the law which varies and changes with the interests, habits, needs, sentiments, and fashions of the day." BALLENTINE'S LAW DICTIONARY 1023 (3d ed. 1969) (quoting Wallihan v. Hughes, 82 S.E.2d 553 (Va. 1954)). One often cited definition of "public policy" in retaliatory discharge cases appears in Pierce v. Ortho Pharmaceutical Corp., 417 A.2d 505, 511 (N.J. 1980). The *Pierce* court, in defining "public policy," stated:

> [W]e must balance the interests of the employee, the employer, and the public. Employees have an interest in knowing they will not be discharged for exercising their legal rights. Employers have an interest in knowing they can run their businesses as they see fit as long as their conduct is consistent with public policy. The public has an interest in employment stability and in discouraging frivolous lawsuits by dissatisfied employees.

*Id.*

*See also* Brockmeyer v. Dun & Bradstreet, 335 N.W.2d 834, 841 (Wis. 1983) (expanding and explaining the same definition without citing to *Pierce*, the court explains that (1) employees are safeguarded against employer's acts that undermine fundamental policies, (2) employers retain flexibility to make needed personnel decisions during changing economic conditions, and (3) society benefits from a stable job market and the protection

effectuate the state's declared policy against perjury" employers must be denied the unlimited right to discharge at-will employees when the reason for dismissal was the employee's refusal to commit perjury.[21] As a result, violations of "public policy" should be defined as whatever contravenes good morals or any established interests of society, and "that which has a tendency to be injurious to the public or against the public good."[22] In reversing the trial court, the *Petermann* court found that the employee sufficiently alleged a cause of action.[23]

Fourteen years later, in 1973, a series of trend setting cases began to lay out a framework of the types of employer actions that violate "public policy." The Indiana Supreme Court in *Frampton v. Central Gas*

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against frivolous lawsuits since discharged employees who do not allege a clear expression of public policy violation will be dismissed on summary judgment or failure to state a claim); BLACK'S LAW DICTIONARY 1231 (6th ed. 1990) (defining "public policy" as "that general and well-settled public opinion relating to man's plain, palpable duty to his fellowmen, having due regard to all circumstances of each particular relation and situation."); Elletta S. Callahan, *The Public Policy Exception to the Employment At Will Rule Comes of Age: A Proposed Framework for Analysis*, 29 AM. BUS. L.J. 481, 486 & n.32 (1991) (noting inconsistencies in the articulation of the interests involved in various case law definitions of "public policy").

21. *Petermann*, 344 P.2d at 27. The employer advised the employee on the day before the legislative committee hearing that the employee's work was "highly satisfactory," and that the employee's discharge the day following the hearing was to "punish [the employee] for testifying truthfully." *Id.* at 28. This case thus anticipates Blades' argument that employees should be permitted to bring a tort action rather than a contract action. Blades, *supra* note 15, at 1422.

22. *Id.*

23. *Petermann*, 344 P.2d at 27. In 1980, the California Court of Appeals sustained a wrongful discharge cause of action in tort brought by an employee who refused to violate the Sherman Antitrust Act by participating in his employer's price fixing scheme. Tameny v. Atlantic Richfield Co., 610 P.2d 1330 (Cal. 1980). The court noted the factual similarity to *Petermann* and the fact that wrongful acts committed in the course of a contractual relationship may afford both tort and contractual relief; thus the existence of a contractual relationship does not bar the pursuit of redress in tort. *Id.* at 1334. The court found that an employer's authority over its employee precludes the right to order the employee to commit a criminal act or coerce compliance with unlawful directions by discharge or threat. In the same year, the same court decided Cleary v. American Airlines, 111 Cal. App. 3d 443 (1980). Here, the court held that the employee's termination without legal cause, after 18 years of satisfactory performance violated the implied-in-law covenant of good faith and fair dealing. *Id.* at 455-56. The longevity of the employee's service combined with detrimental reliance on the employer's express employment policies operated as estoppel precluding discharge without good cause. *Id.*

For a chronological survey of recent California wrongful discharge cases, see Dabbs v. Cardiopulmonary Management Servs., 188 Cal. App. 3d 1437 (1987) (hospital respiratory therapist was not required to allege violation of a specific statute to state a wrongful discharge cause of action, but since the employee quit voluntarily, no constructive discharge could be pleaded without alleging violation of a specific statute or actual termination); Foley v. Interactive Data Corp., 765 P.2d 373 (Cal. 1988) (public policy questions must involve a matter that affects society at large rather than a personal or proprietary interest of employee or employer, and the policy must be well established or substantial); Gantt v. Sentry Ins., 824 P.2d 680 (Cal. 1992) (recognizing violations of employment public policy as falling into four categories: (1) refusing to violate a statute, (2) prohibiting the performance of a statutory obligation, (3) discharge for exercising a statutory right or privilege, and (4) discharge for reporting an alleged violation of a statute of public importance; affirming employee's cause of action without federal law preemption for termination in retaliation for testifying truthfully on behalf of a co-worker's sexual harassment claim). For a more detailed discussion of California wrongful termination law, see Kempf and Taylor, *supra* note 15.

*Co.*[24] analogized retaliatory discharge with retaliatory eviction in landlord-tenant law, holding that termination of an employee in retaliation for filing a Workers' Compensation claim "undermines a critically important public policy."[25] The court held that the employee stated a cause of action as an exception to the general at-will employment rule because the retaliatory discharge by the employer was an intentional, wrongful act entitling the employee to compensation.[26]

Retributive tort concepts of bad faith blended with contract principles in several subsequent cases. In 1974, the Supreme Court of New Hampshire, in *Monge v. Beebe Rubber Co.*,[27] held that a breach of employment contract occurs when an at-will employee's discharge is motivated by bad faith, malice, or retaliation.[28] The court stated that employment contracts must be balanced between the interests of both parties.[29] In a similar application of precedent, the New Hampshire Supreme Court in *Cloutier v. Great Atlantic & Pacific Tea Co.*,[30] held that an employee of over 35 years articulated a public policy cause of action when he was terminated as a store manager for a burglary that occurred in his store on his day off, because he was "at all times" responsible for the cash in the employer's store.[31] The *Cloutier* court held that to articulate a public policy exception to the at-will employment doctrine, the employee must

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24. 297 N.E.2d 425 (Ind. 1973).

25. *Id.* at 428. Interference with a citizen's rights, such as filing for worker's compensation or serving on a jury, represent clearly defined examples of "public policy" violations. *See supra*, note 20 (definitions of "public policy").

26. *Frampton*, 297 N.E.2d at 428. In addition to implying that this action sounds in tort, the court hypothesized that if an employee has no remedy for retaliatory discharge, "[w]hat then is to prevent an employer from coercing an employee?" *Id.*

27. 316 A.2d 549 (N.H. 1974).

28. *Id.*

29. *Id.* at 551. In *Monge*, when an employee needed more materials to do her job, which were refused, she was manipulated into a "no-win" situation and was fired that evening for refusing a foreman's order. The employee alleged that, in reality, she was harassed by her foreman because she refused to go out with him. His anger, condoned by the personnel manager, resulted in her termination. *Id.* at 550. She was reinstated after complaining to the union, but became ill a few days later requiring a hospital stay. The employer then terminated the employee for allegedly failing to "call-in" for a three day period. *Id.* at 550-51. The court set forth a concise formula for evaluating employment contracts:

> In all employment contracts, whether at will or for a definite term, the employer's interest in running his business as he sees fit must be balanced against the interest of the employee in maintaining his employment, and the public's interest in maintaining a proper balance between the two.

*Id.* at 551. The court reasoned that the decision would create a "certain stability of employment," yet would not interfere with the reasonable business judgment to discharge employees freely so as to operate efficiently and profitably. *Id.* at 552. *See* Blades, *supra* note 15; Blumrosen, *supra* note 15.

30. 436 A.2d 1140 (N.H. 1981).

31. *Id.* at 1143-45. The court noted elements of bad faith: the employer discontinued police protection for employees making deposits late at night in an unsafe area and condoned leaving the cash in the safe overnight for deposit the next day; the employer later claimed the employee violated company policy; immediately after a burglary, the employer resumed police accompaniment. *Id.* at 1144. Additionally, the employee was suspended after a five minute meeting and was discharged in a similar manner after thirty-six years of employment for the employer, while the assistant manager on duty when the burglary occurred was not discharged. *Id.* The court noted that employees are entitled to a day off, and cannot be responsible to their employer "at all times." *Id.* at 1145.

first show that the employer was motivated by bad faith, malice, or retaliation.[32] Secondly, the employee must demonstrate that he was discharged because he performed an act encouraged by public policy, or refused to perform an act that public policy would condemn.[33]

The definition and scope of "public policy" was substantially broadened to include general societal interests in another important precursor to the *Lorenz* case, *Nees v. Hocks*.[34] Here, the Oregon Supreme Court held that the employer was liable, by exception to the at-will employment rule, for discharging the employee because she *wanted* to serve on a jury.[35] The court recognized certain circumstances in which an employer may commit a public policy tort by discharging an employee for a socially undesirable motive.[36] Thus, the *Nees* court created a right of recovery for employees when "substantial societal interests" had been violated.[37] Similarly, in 1978, West Virginia recognized, in *Harless v. First Nat'l Bank in Fairmont*,[38] a cause of action in tort when the employer's motivation for discharge contravenes substantial public policy.[39] The *Harless* court held that discharging an employee in retaliation for attempts to bring state and federal consumer credit law violations to the attention of the employer was a violation of public and statutory policies when the employee was protected by the statute.[40]

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32. *Id.*

33. *Id.* at 1143-44. The employee in *Cloutier* argued that the employer violated the Occupational Safety and Health Act of 1970 (OSHA), 29 U.S.C. § 654(a) (1988), by not providing police protection and endangering employees with recognized hazards at the place of employment. But the court stated that regardless of OSHA, the facts supported the conclusion that the employee was discharged for furthering the public policy objective of protecting the employees under him. *Cloutier*, 436 A.2d at 1145. *But see* Geary v. United States Steel Corp., 319 A.2d 174 (Pa. 1974). In *Geary*, the employee was an at-will salesman. When the employee complained to his employer that new tubular casings designed for high-pressure use were dangerous to anyone using it, and that the testing was inadequate, the employee was ordered to "follow directions," which the employee did. *Id.* at 175. The employee persisted in taking his case to the "top" of the company, eventually resulting in the product being reevaluated and withdrawn from the market. The employee alleged his dismissal without notice violated general public policy and was malicious and abusive. *Id.* The court declared Pennsylvania an at-will state, denying the employee's cause of action for discharge in violation of public policy. *Id.* at 174-80.

Here, in contrast to the *Lorenz* case, the employee was not an expert in matters of public safety, and the court stated that mere good intentions would not overcome the employer's legitimate right to discharge him at will. *Id.* The court hinted that a high ranking employee or expert might be treated differently, but here the employee bypassed his immediate superiors trying to use "inside contacts." *Id.* The court concluded that balancing the interests of both parties weighed in favor of the employer, and the discharge was not a "spiteful retaliatory gesture designed to punish" the employee. *Id.* at 180 n.15. The court added in dictum that it was not necessary to reject other jurisdiction's public policy exceptions, but this employee failed to show "clear and compelling" mandates of public policy. *Id.* at 180.

34. 536 P.2d 512 (Or. 1975).

35. *Id.* at 516.

36. *Id.* at 515. *See also* Delaney v. Taco Time Int'l, Inc., 681 P.2d 114 (Or. 1984) (holding employer liable for discharging the employee after the employee refused to sign tortious and defamatory statements concerning another employee).

37. *Nees*, 536 P.2d at 516.

38. 246 S.E.2d 270 (W. Va. 1978).

39. *Id.* at 275.

40. *Id.* at 275-76.

*Harless* and *Nees* were influential in developing a public policy exception to at-will employment because they recognized that strict adherence to the at-will doctrine could bring potential harm to society in general, such as degradation of the jury system or unchecked dishonest banking procedures. In addition, other states contributed to the wealth of cases representing the expansion of public policy exceptions to the at-will rule doctrine influential to the *Lorenz* decision.[41] While Colorado never expressly rejected the possibility of recognizing a tort cause of action for

41. For example, in a chronological sampling, see Trombetta v. Detroit, Toledo & Ironton R.R. Co., 265 N.W.2d 385 (Mich. Ct. App. 1978) (recognizing exceptions to the at-will employment rule when actions contravene public policy when, as here, the employee was discharged for refusing to manipulate pollution control reports to be filed with the state pursuant to statute); Sheets v. Teddy's Frosted Foods, Inc., 427 A.2d 385 (Conn. 1980) (dismissing an employee for ensuring that the employer's products comply with state law violates public policy when the employee must choose between risking criminal sanction or jeopardizing continued employment); Keneally v. Orgain, 606 P.2d 127 (Mont. 1980) (recognizing public policy exceptions as refusal to self-perjure, retaliation for employee's filing of Workers' Compensation benefits, refusal of sexual relations, and possibly others in the future, but denying a cause of action to the employee for failure to state a substantial or specific violation of public policy; common law now superseded by MONT. CODE ANN. §§ 39-2-903 to 914); Palmateer v. International Harvester Co., 421 N.E.2d 876 (Ill. 1981) (employee stated cause of action when he was discharged in retaliation for helping gather information to give to a local law enforcement agency concerning a co-worker's possible criminal misconduct); Clanton v. Cain-Sloan Co., 677 S.W.2d 441 (Tenn. 1984) (holding that an exception to the at-will rule exists when an employee is fired in retaliation for exercising Workers' Compensation rights); Thompson v. St. Regis Paper Co., 685 P.2d 1081 (Wash. 1984) (rejecting the "good faith" contract argument, but endorsing breach of implied-in-fact contracts of employment when certain policies in the employee manual have been detrimentally relied on by the employee, and recognizing a tort cause of action for employee discharge in violation of clear mandates of public policy); Wagenseller v. Scottsdale Memorial Hosp., 710 P.2d 1025 (Ariz. 1985) (recognizing a "bad cause" exception to the at-will doctrine, which serves society's interest in preventing employers from discharging employees for morally wrong reasons, such as here, where the employee was fired by her supervisor in retaliation for refusing to "moon" the audience along with the other participants in a campsite skit); Allen v. Safeway Stores Inc., 699 P.2d 277 (Wyo. 1985) (recognizing that a wrongful discharge tort action as a public policy exception requires (1) that the discharge violate some well-established public policy; and (2) there be no pre-existing remedy available to the employee); Johnson v. World Color Press, Inc., 498 N.E.2d 575 (Ill. App. Ct. 1986) (employee discharged for disclosing violations of federal security and fraud laws). For an insightful view of the Washington wrongful discharge law, see Peck, *Penetrating Doctrinal Camouflage*, *supra* note 10. For an analysis of *Wagenseller*, *see* Goldsmith, *supra* note 15.

*But see, e.g.*, Whittaker v. Care-More, Inc., 621 S.W.2d 395 (Tenn. Ct. App. 1981) (denying employee's request to modify the at-will rule when the employer failed to comply with broad claims of available work made in the employee manual, and recognizing the likelihood of frequent and vexatious lawsuits if the doctrine is changed). Note that Tennessee does not recognize an exception in contract actions, only in tort as public policy exceptions. *See* Clanton v. Cain-Sloan Co., 677 S.W.2d 441 (Tenn. 1984). Examples of other cases denying an exception to the at-will doctrine include Muller v. Stromberg Carlson Corp., 427 So.2d 266 (Fla. Dist. Ct. App. 1983) (refusing to modify the at-will doctrine) and Murphy v. American Home Prods. Corp., 448 N.E.2d 86 (N.Y. 1983) (no implied obligation of good faith exists in employment contracts, and that rather than make new judicial law, the legislature should interpret public policy).

For a detailed state by state analysis of the acceptance of the public policy wrongful discharge cause of action, see *Lorenz*, 823 P.2d 100, 106-7 nn.2-5. Some clarification of jurisdictional categories should be noted. Delaware is listed as declining the public policy exception. *Id.* at 106 n.4. But in March 1992, a lower court recognized a public policy exception to the at-will employment rule. The employee's cause of action for wrongful termination was sustained after he was terminated in retaliation for refusing to carry out criminal acts which would have set prices in a government contract in excess of federal

wrongful discharge, several years would pass before the Colorado Supreme Court was presented with the right combination of a strong claim and supporting opinions of the Colorado Court of Appeals and other populous jurisdictions.

### C. *Prior Colorado Cases*

In 1974, well before the recognition of a tort public policy exception, the Colorado Court of Appeals decided *Justice v. Stanley Aviation Corp.*[42] This contract case involved a discharged employee claiming that his confirmation letter of employment from the employer at $12,000 per year was for a definite period of one year, and that his discharge three and a half months later constituted a breach of employment contract.[43] Applying the at-will doctrine, the court rejected this argument but did not eliminate possible exceptions in contract, such as special consideration.[44] The late 1980's brought a new era of expansion in Colorado contract employment law, recognizing reasonable expectations of employees that employers should also be bound by their own promulgated disciplinary and termination procedures. For example, in *Continental Airlines v. Keenan,*[45] the Colorado Supreme Court held that an employee's reliance upon the specific procedures set out in the employee handbook may be enforceable under contract theories of promissory estoppel or unilateral contract supported by the employee's continued performance.[46] This principle remains sound in subsequent contract employment law decisions in Colorado.[47]

The issue of whether a tort cause of action could be sustained for

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regulations. Henze v. Alloy Surfaces Co., No. 91C-06-20, 1992 WL 51861, at *2 (Del. Super. Ct. March 16, 1992).

Maine, Iowa and Utah are listed as not having ruled on the issue. *Lorenz*, 823 P.2d at 107 n.4. While Maine has not yet determined what type of public policy exceptions might qualify for an exception to the at-will doctrine, the Maine Supreme Court hinted that a wrongful discharge cause of action might exist if the record shows a clearly defined contravention of public policy. Wilde v. Houlton Regional Hosp., 537 A.2d 1137 (Me. 1988). In 1989, the Iowa Supreme Court in Fogel v. Trustees of Iowa College, 446 N.W.2d 451 (Iowa 1989), noted two exceptions to the employment at-will doctrine: (1) tort liability when a discharge is in clear violation of a well recognized and defined public policy, and (2) detrimental reliance by an employee on a contract created by the employer's policy manual. In 1990, the Iowa Supreme Court expanded the scope of exceptions to include intimidation of employees into foregoing benefits entitled to them or risk losing their jobs. Smith v. Smithway Motor Xpress, Inc., 464 N.W.2d 682 (Iowa 1990). In Hodges v. Gibson Prods. Co., 811 P.2d 151 (Utah 1991), the Utah Supreme Court held that employment at-will is limited by public policy exceptions, although the court declined to indicate whether such a wrongful discharge would be in tort or contract. In Peterson v. Browning, 832 P.2d 1280 (Utah 1992), the court held that violations of statutes clearly expressing Utah public policy are an exception to at-will employment sounding in tort. *Id.* at 1283-85.

42. 530 P.2d 984 (Colo. Ct. App. 1974).

43. *Id.* at 985.

44. *Id.* at 986.

45. 731 P.2d 708 (Colo. 1987).

46. *Id.* at 711-12.

47. *See, e.g.*, Churchey v. Adolph Coors Co., 759 P.2d 1336 (Colo. 1988) (employer's failure to follow its own employment policies to be evaluated under the *Continental Airlines* standard); Allabashi v. Lincoln Nat'l Sales Corp., 824 P.2d 1 (Colo. Ct. App. 1991) (affirming jury verdict finding employer in breach of implied contract or promissory estoppel

wrongful discharge was first addressed by the Colorado Court of Appeals in *Lampe v. Presbyterian Medical Center*.[48] Here, a nurse was discharged after she attempted to comply, contrary to the supervisor's instructions, with her own interpretation of Colorado statutory regulations regarding adequate nursing shift-coverage. Faced with the issue of retaliatory termination, the court declined to expand tort law to limit the employment at-will doctrine. Significantly, however, the court left open the possibility of future wrongful discharge actions in tort if employees relied on specifically enacted statutory rights or duties,[49] as opposed to a "broad, general statement of policy"[50] similar to the statute relied on by the employee in *Lampe*.[51]

In 1988, the Colorado Court of Appeals recognized a cause of action for wrongful termination in *Montoya v. Local 3 of the International Brotherhood of Electrical Workers*.[52] Here, the employee was discharged for refusing to assist in illegal practices by management of the union.[53] The

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for failure to follow termination procedures in an employment manual relied upon by the employee). *See also supra* notes 42-46 and accompanying text.

Traditional contract causes of action in employment cases continue to be an available alternative to tort actions. *See* Pittman v. Larson Distrib. Co., 724 P.2d 1379 (Colo. Ct. App. 1986) (issue of fact existed as to whether the employee's employment contract as a salesman was terminable at will, or "permanent" employment supported by special consideration such as lower pay, experience or customer contacts); Magnuson v. Smith and Saetveit, P.C., 722 P.2d 1020 (Colo. Ct. App. 1986) (employee's refusal to obey employer's reasonable instructions constitutes a material breach of employment contract); Feiger, *supra* note 10, at 734-35.

48. 590 P.2d 513 (Colo. Ct. App. 1978).

49. Frampton v. Central Ind. Gas Co., 297 N.E.2d 425 (Ind. 1973) (employee terminated for filing Workers' Compensation claim stated a public policy exception to the at-will rule). *Supra* notes 24-26 and accompanying text. In Stivers v. Stevens, 581 N.E.2d 1253 (Ind. Ct. App. 1991), the court expanded on *Frampton* holding that the discharge of an employee for merely suggesting that a Workers' Compensation claim would be filed, was an even stronger rationale for the *Frampton* exception to the employment at-will doctrine. *See* Barbara J. Fick, *1991 Survey of Recent Developments in Indiana Law: Labor and Employment Law*, 25 Ind. L. Rev. 1311, 1315 (1992) (the Indiana Supreme Court recognizes coercion of an employee as a public policy exception).

50. COLO. REV. STAT. §§ 12-38-201 to -217 (1973) (current version at COLO. REV. STAT. §§ 12-38.1-101 to -119 (1988)).

51. *Lampe*, 590 P.2d at 515. *See* Corbin v. Sinclair Mktg., Inc., 684 P.2d 265 (Colo. Ct. App. 1984). *Corbin* was similar to *Lampe*. The employee in *Corbin* claimed wrongful discharge in violation of the Colorado Minimum Wage Act, COLO. REV. STAT. § 8-3-1086(2)(a) and OSHA, 29 U.S.C. § 654(a), when his employer directed him to perform certain hazardous tasks. The *Corbin* court upheld the *Lampe* decision, holding that the statutes relied on by the employee were broad general statements of policy similar to those held to be inadequate in *Lampe* to justify adoption of an exception to the employment at-will rule. *Corbin*, 684 P.2d at 267. In answer to the employee's argument that his termination was in violation of the company's own policy manual and thus a breach of contract, the court upheld the at-will rule for employment contracts. *Id.* at 267. *But see* Continental Airlines v. Keenan, 731 P.2d 708 (Colo. 1987) (Colorado now recognizes promissory estoppel actions resulting from employment handbooks distributed to the employees). *Supra* notes 42-47 and accompanying text.

52. 755 P.2d 1221 (Colo. Ct. App. 1988). The court neither laid out the necessary elements required for a *prima facie* case, nor the necessary causation analysis. The court simply reversed and remanded the trial court's summary judgment dismissal of the wrongful discharge claim.

53. *Id.* at 1224-25. The court held that federal law did not preempt the employee's state court action of wrongful discharge, and an issue of fact existed as to whether the employee was wrongfully discharged for refusing to assist in illegal activities. Note that

*Montoya* court did not reach the issue of whether or not the action sounded in tort. Later that same year, however, the Court of Appeals, in *Cronk v. Intermountain Rural Electric Association* (*Cronk I*),[54] recognized the tort of wrongful discharge and defined the five steps necessary to establish a *prima facie* wrongful discharge exception to the employment at-will doctrine later adopted and modified by the *Lorenz* court.[55] In *Cronk I*, the employees alleged wrongful discharge for refusing to engage in illegal and irregular practices prohibited by Colorado public utility statutes.[56] The *Cronk I* decision represented a major step toward establishing solid exceptions to Colorado's employment at-will doctrine. Nevertheless, the court did not expressly hold that the action sounded in tort. In 1989, the Court of Appeals augmented *Cronk I* with its decision in *Lathrop v. Entenmann's, Inc.*,[57] allowing a wrongful discharge claim for retaliation against the employee who exercised Workers' Compensation benefits.[58] The court expressly recognized an exception to the at-will termination rule, and expanded the scope of the *Cronk I* public policy exception.[59]

Federal courts in Colorado have closely paralleled Colorado decisions recognizing exceptions to the at-will doctrine. In 1989, the U.S. District Court, in *Miedema v. Browning-Ferris Industries of Colorado*,[60] followed Colorado's determination that an employee discharged for exercising specific statutory rights or duties supports a cause of action for wrongful termination.[61] More recently, in *Mares v. Conagra Poultry Co.*,[62]

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this case is factually similar to California's Petermann v. International Brotherhood of Teamsters Local 396, 344 P.2d 25 (Cal. Ct. App. 1959) (employee discharged for refusing to commit perjury to a legislative committee); *supra* notes 17-23 and accompanying text. *See also* Farmer v. Central Bancorporation, 761 P.2d 220 (Colo. Ct. App. 1988) (suggesting that employee's discharge for refusal to violate federal banking laws could fall within a public policy exception to at-will employment, but the employee was unable to prove a violation); Gamble v. Levitz Furniture Co., 759 P.2d 761 (Colo. Ct. App. 1988), *cert. denied*, 782 P.2d 1197 (Colo. 1989) (employee's claim for wrongful discharge, if available, is not available at common law when wrongful discharge remedies are provided for by statute).

54. 765 P.2d 619 (Colo. Ct. App. 1988), *cert. denied* (*Cronk I*) *appeal after remand*, 140 L.R.R.M. (BNA) 2149 (Colo. Ct. App. April 2, 1992), *cert. denied* (*Cronk II*).

55. *Id.* at 622 ((1) the employee refused to perform an action; (2) ordered by the employer; (3) which would violate a specific statute; (4) whose terms are more than a broad general statement of policy; and (5) that the employee's termination resulted from the refusal to perform such action). *See supra* notes 5-6 and accompanying text.

56. COLO. REV. STAT. §§ 40-6-103 to -106 (1984).

57. 770 P.2d 1367 (Colo. Ct. App.), *cert. dismissed*, 778 P.2d 1370 (Colo. 1989).

58. *Id.* at 1371-73.

59. *Id.* at 1373. The *Lathrop* court relied heavily on Frampton v. Central Ind. Gas Co., 297 N.E.2d 425 (Ind. 1973). *See supra* notes 24-26 and accompanying text; *Martin Marietta v. Lorenz*, 823 P.2d at 108 (Colo. 1992) (discussion of *Lathrop* and *Frampton*).

60. 716 F. Supp. 1369 (D. Colo. 1989).

61. *Id.* at 1371. The court, relying on *Lathrop*, 770 P.2d at 1367, held that Colorado law precludes discharging an employee for filing a Workers' Compensation claim. *See supra* notes 57-59 and accompanying text. *See also* Vaske v. DuCharme, McMillen & Assocs., Inc., 757 F. Supp. 1158 (D. Colo. 1990) (recognizing Colorado retaliation claims when employees exercise statutorily protected rights or obligations, or are discharged for refusing to commit a criminal act directed by the employer but refusing to expand existing Colorado tort law).

62. 773 F. Supp. 248 (D. Colo. 1991), *aff'd*, 971 F.2d 492 (10th Cir. 1992) (applying the modified *prima facie* standards of *Lorenz* and affirming Chief Judge Finesilver's District

the U.S. District Court declined to apply the public policy exception in the earlier 1990 Colorado appellate decision in *Lorenz v. Martin Marietta*[63] because the employee failed to allege that she was directed to violate a criminal law.[64] The court ruled,[65] and the Tenth Circuit affirmed,[66] that a federal court should not expand the existing wrongful termination law or create a new category of exceptions to the general at-will employment rule. The court held no action may be maintained based solely on the employee's allegations that she was fired for exercising statutory rights under Colorado's physician/patient testimonial privilege by refusing to complete a medical form as part of the employer's drug testing policy, when the employee did not contend the testing itself to be illegal.[67] In the 1992 post-*Lorenz* case of *Smith v. Colorado Interstate Gas Co.*,[68] the U.S. District court acknowledged that current Colorado law recognizes several public policy exceptions to the at-will employment doctrine, and allowed the employee's claims under these exceptions.[69] Although the Tenth Circuit has followed state law closely,[70] not all the federal courts have done the same.[71]

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Court ruling that summary judgment for the employer was proper as the employee "never contended that she was being asked to perform an illegal act").

63. 802 P.2d 1146 (Colo. Ct. App. 1990), *aff'd as modified*, 823 P.2d 100 (Colo. 1992).

64. *Mares*, 773 F. Supp. at 252.

65. *Id.*

66. 971 F.2d 492 (10th Cir. 1992). On appeal, the Tenth Circuit affirmed the district court's reasoning, despite the application of the recently announced 1992 Martin Marietta v. Lorenz decision. *Id.* at 494-96.

67. *Id. See* COLO. REV. STAT. § 13-90-107(1) (1973).

68. 794 F. Supp. 1035 (D. Colo. 1992).

69. *Id.* at 1040-42. The court based its decision partially on both *Lorenz*, 823 P.2d 100 (Colo. 1992), and Continental Airlines v. Keenan, 731 P.2d 708 (Colo. 1987).

70. *See, e.g.*, Cooper v. Schneider Metal Mfg. Co., 945 F.2d 411, No. 90-1158 (10th Cir. 1991) (unpublished opinion of Table Decision) (District of Colorado court applying Oklahoma law in the absence of applicable Colorado public policy exception law, but recognizing the *Lathrop* decision recognizing retaliatory discharge for filing Workers' Compensation claims); White v. American Airlines, 915 F.2d 1414 (10th Cir. 1990) (employee alleged a retaliatory discharge for refusing to commit perjury on behalf of American Airlines concerning the 1979 DC-10 crash in Chicago, and the court followed Oklahoma law); Polson v. Davis, 895 F.2d 705 (10th Cir. 1990) (following Kansas law); Horne v. J.W. Gibson Well Serv. Co., 894 F.2d 1194 (10th Cir. 1990) (applying Wyoming law); Zaccardi v. Zale Corp., 856 F.2d 1473 (10th Cir. 1988) (employee's refusal to sign polygraph consent form did not violate any clear mandate of New Mexico public policy); Howcroft v. Mountain States Tel. & Tel. Co., 712 F. Supp. 1514 (D. Utah 1989) (applying Utah law).

71. Several well known federal cases have denied recovery for wrongful termination based on retaliation or public policies: Guy v. Travenol Labs., Inc., 812 F.2d 911 (4th Cir. 1987) (employee discharged for refusing to falsify records required by the Food and Drug Administration did not state an exception to the North Carolina at-will doctrine); Percival v. General Motors Corp., 539 F.2d 1126 (8th Cir. 1976) (executive alleging a malicious discharge by colleagues did not state a cause of action for wrongful termination); Fulford v. Burndy Corp., 623 F. Supp. 78 (D.N.H. 1985) (employee alleging a retaliatory discharge for having filed suit against his employer for injuries incurred by the employer's dog did not state a cause of action under New Hampshire law).

## III. THE INSTANT CASE: *MARTIN MARIETTA V. LORENZ*[72]

### A. *Facts*

Prior to accepting employment from Martin Marietta in 1972, Lorenz worked for Boeing Aircraft Co. on defense and aerospace projects for 16 years[73] as a specialist in fracture mechanics.[74] Lorenz was well educated at the time he accepted employment with Martin Marietta.[75] As a "principal investigator"[76] for Martin Marietta, Lorenz was responsible for quality control of projects contracted for with the National Aeronautics and Space Administration (NASA). Lorenz complained to his supervisors on several occasions about inadequate testing and poor workmanship on three separate projects.[77]

Lorenz advised his supervisor that "NDI"[78] contract proposals made to NASA involved unrealistic cost assessments resulting in a false contract price.[79] Lorenz advised his supervisors that the data was not being communicated to the appropriate NASA personnel.[80] When no action was taken by Martin Marietta, Lorenz contacted the NASA project manager to relay the data.[81] As a result of Lorenz's actions, a technical review session was held by Martin Marietta with NASA and significant technical issues about the Shuttle's safety were discussed.[82] Lorenz, who accurately drafted the minutes of the meeting,[83] was instructed by a superior to make modifications to them. Lorenz claimed the requested modifications would not accurately reflect the course of the meeting.[84] Lorenz refused to make the changes, and instead issued a memorandum stating that the modifications to the minutes were inaccurate. Lorenz

72. 823 P.2d 100 (Colo. 1992).

73. *Id.* at 102.

74. The study of stress resistance and tolerances for materials used in the construction of defense and aerospace equipment. *Id.*

75. Lorenz held a Bachelor's degree in mechanical engineering from Polytechnic Institute of Brooklyn, a Master's degree in mechanical engineering from the University of Washington, and a doctoral candidate in metallurgy at Colorado School of Mines. *See* Brief Amicus Curiae by the National Employment Lawyers Association (NELA) for the Respondent at 1, Martin Marietta v. Lorenz, 823 P.2d 100 (Colo. 1992) (No. 90 SC 583).

76. The Principal Investigator is accountable for technical objectives. *Id.*

77. The "NDI Contract" was for the purpose of producing data regarding the quality of Space Shuttle external tank designs, the "Mixed Mode Contract" involved building a testing machine to be initially researched and developed with a $25,000 NASA contribution, and the "Tug Irad Contract" was for a space "tug" vehicle. *Lorenz*, 823 P.2d at 103.

78. The words which correspond to "NDI" are not spelled out in any of the *Lorenz* appellate briefs or opinions. Although one possible definition of "NDI" is former President Reagan's "National Defense Initiative," it is not clear whether the "NDI" Contract in *Lorenz* has any connection with Reagan's "National Defense Initiative" defense policy.

79. Respondent's Answer Brief at 5, *Lorenz* (No. 90 SC 583).

80. *Id.*

81. *Lorenz*, 823 P.2d at 103.

82. Respondent's Answer Brief at 5, *Lorenz* (No. 90 SC 583).

83. *Id.*

84. Martin Marietta claimed that Lorenz never accused his superior of making false statements; that Lorenz considered the changes to be "new statements" of "new information;" and that Lorenz was really concerned with pride of authorship of the minutes. Further, "even if [the] additions were inaccurate, they were trivial." Petitioner's Reply Brief at 19-20, Martin Marietta v. Lorenz, 823 P.2d 100 (Colo. 1992) (No. 90 SC 583).

was subsequently warned by management to start cooperating.[85]

On another occasion, Lorenz was pressured to attest to the adequacy of a material for the Mixed Mode Contract.[86] Lorenz discovered that the machine could not perform its function due to shoddy workmanship.[87] He further learned that Martin Marietta had instructed employees to construct the machine for $10,000 instead of the $25,000 that NASA allocated.[88] When Lorenz complained to his supervisors, he was ridiculed.[89] A similar incident occurred concerning the Tug Irad Contract. Despite the "enormous pressure levied against him", Lorenz refused to attest to the adequacy of the material selected for the Tug,[90] and refused to write the final report because the testing was, in his opinion, inadequate.[91] Shortly thereafter Lorenz was terminated.[92]

B. *Case History*

After the presentation of Lorenz's case, the trial court granted Martin Marietta's motion to dismiss for failure to state a claim, stating that Colorado did not recognize common law tortious wrongful termination.[93] The Court of Appeals reversed, recognizing a tort claim for wrongful termination based upon a public policy exception,[94] and ap-

85. *Lorenz*, 823 P.2d at 103.

86. *Id.*

87. *Id.*

88. *Id.* Respondent's Answer Brief at 7, *Lorenz* (No. 90 SC 583).

89. Respondent's Answer Brief at 7, *Lorenz* (No. 90 SC 583); Brief Amicus Curiae at 4, *Lorenz* (No. 90 SC 583).

90. Respondent's Answer Brief at 8, *Lorenz* (No. 90 SC 583).

91. *Lorenz*, 823 P.2d at 103. Lorenz stated in testimony that "these types of issues could not be compromised without compromising . . . [his] professional integrity," or without "jeopardizing the very purpose of . . . [his] involvement" with safety in Martin Marietta's projects, and to do so would amount to "a downright fraud[.]" *Id.*

92. *Id.* at 104. Lorenz was notified of his lay-off status on July 22, 1975, and his last day of work was July 25, 1975. Lorenz filed this action on July 24, 1981. *Id.* at 115. Lorenz filed his action one day short of the expiration of the applicable statute of limitations. For a discussion of the application of the statute of limitations, see *infra* notes 93-94, 113.

93. Lorenz v. Martin Marietta Corp., 802 P.2d 1146 (Colo. Ct. App. 1990), *aff'd as modified*, 823 P.2d 100 (Colo. 1992). Colorado does have limited statutory relief for "whistleblowers:" COLO. REV. STAT. §§ 24-50.5-101 to -107 (1973) ("whistleblower" statute for protection of state employees); COLO. REV. STAT. § 5-5-106 (1973) (prohibiting termination of employees with garnered wages); COLO. REV. STAT. §§ 8-2-104, -107 (1973) (prohibiting fraudulent procurement of employees); COLO. REV. STAT. § 8-2-108 (1973) (prohibiting political firings); COLO. REV. STAT. § 8-2-108 (1)(h) (1973) (prohibiting terminations for testifying under the Labor Peace Act); COLO. REV. STAT. § 13-71-118 (1973) (prohibiting terminations of employees on jury duty). *See* Respondent's Answer Brief at 30, *Lorenz*, (No. 90 SC 583) (listing Colorado statutes restricting employer's ability to terminate their employees). The court also based the dismissal on the fact that the six-year statute of limitations started on the day Lorenz was notified of his lay-off, thus barring the action. *Lorenz*, 802 P.2d at 1148. *See* COLO. REV. STAT. § 13-80-110 (1973); *supra* note 92; *infra* notes 94, 113.

94. Lorenz v. Martin Marietta Corp., 802 P.2d 1146 (Colo. Ct. App. 1990), *aff'd as modified*, 823 P.2d 100 (Colo 1992). The appellate court also stated that the statute of limitations began to run on the day after Lorenz was terminated—the day his "injury" occurred. *Id.* at 1148-49. The court rejected Martin Marietta's argument that the statute began to run on the day Lorenz was notified. Martin Marietta's argument was based on authority involving discharges covered by state or federal statutes which provided specific filing requirements. *Id. See also* Quicker v. Colorado Civil Rights Comm'n, 747 P.2d 682

plied the *Cronk I* standard.[95] Lorenz had also alleged a violation of U.S.C. § 1001,[96] which the court held was specific enough to cover the fraud which Lorenz alleged led to his wrongful termination.[97] Applying the *Cronk I* standard retroactively,[98] the court determined that claims arising out of the state's public policy did not preempt federal labor laws.[99]

### C. *The Colorado Supreme Court Opinion*

As a matter of first impression, the Colorado Supreme Court recognized a tort-based wrongful discharge cause of action.[100] However, the court modified the *Cronk I*[101] standards by adding a sixth *prima facie* element requiring the employer's knowledge, or unreasonable lack thereof, that the employee refused to perform the employer's directive because of the employee's reasonable belief that the directive was illegal or contrary to public policy.[102] Under the new *prima facie* standard set out by the court, the employee must present evidence:

> [1] that the employer directed the employee to perform an illegal act;
> [2] that the directed act be part of the employee's work related duties; or
> [3] that the employer prohibited the employee from exercising either a public duty or an important job-related right or privilege;
> [4] that the action directed by the employer would violate a specific statute relating to the public health, safety, or welfare, or would undermine a clearly expressed public policy relating to either the employee's basic responsibility as a citizen or the employee's right or privilege as a worker;
> [5] that the employee was terminated as the result of refusing to perform the act directed by the employer; and
> [6] that the employer was aware, or reasonably should have been aware, that the employee's refusal to comply with the

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(Colo. App. 1987) (explaining COLO. REV. STAT. § 24-34-403 [statute of limitation] as applied to a discrimination claim filed with the Colorado Civil Rights Commission; adopting the federal rule in the absence of Colorado case law that notice of discharge begins running the statute, but improper notice equitably tolls it).

95. *Cronk I*, 765 P.2d at 622; *see supra* note 5.

96. 18 U.S.C. § 1001 (1988) (originally enacted as the Act of June 25, 1948, ch. 645, § 1001, 62 Stat. 749). 18 U.S.C. § 1001 provides that:

> Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both.

*Id.*

97. *Lorenz*, 802 P.2d at 1149.

98. *Id.* at 1150.

99. *Id.* at 1150-51.

100. Martin Marietta Corp. v. Lorenz, 823 P.2d 100, 108-10 (Colo. 1992).

101. *Cronk I*, 765 P.2d at 622. For the *Cronk I* elements, see text accompanying notes 4-5.

102. *Lorenz*, 823 P.2d at 109.

> employer's order or directive was based on the employee's reasonable belief that the action ordered by the employer was illegal, contrary to clearly expressed statutory policy relating to the employee's duty as a citizen, or violative of the employee's legal right or privilege as a worker.[103]

The court acknowledged that Colorado has refused to enforce contracts violative of public policy.[104] Following this rationale, the court reasoned that it was "axiomatic" that a *condition* in an employment contract also be unenforceable when it is violative of public policy.[105] Neither an employer nor an employee should be allowed to perpetrate a fraud on the government. Moreover, an employee should not be forced to choose between keeping her job or committing a crime, or foregoing a duty or privilege protected by law.[106]

The court then evaluated Martin Marietta's contention that 18 U.S.C. § 1001 was too broad and general to support a wrongful discharge claim.[107] The *Lorenz* court relied on *United States v. Tobon Builes*,[108] *United States v. Diogo*,[109] and *Johnson v. World Color Press*[110] as guides to the interpretation of 18 U.S.C. § 1001, and determined that the statute was designed to protect the government and innocent people, such as Lorenz, from fraud.[111] The court was divided in a four to three decision on the issue of applying the new standard prospectively or retroactively; the majority holding that retroactive application applied.[112] The *Lorenz* case was remanded for a new trial in accordance

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103. *Id.*

104. Russell v. Courier Printing & Publishing Co., 95 P. 936 (Colo. 1908); Wood v. Casserleigh, 71 P. 360 (Colo. 1902); Pueblo & Ark. Valley R.R. v. Taylor, 6 Colo. 1 (Colo. 1881).

105. *Lorenz*, 823 P.2d at 109.

106. *Id.* at 109-110. The court relied upon *Lathrop, Cronk, Frampton,* and *Nees,* in officially recognizing this cause of action. Lathrop v. Entenmann's, Inc., 770 P.2d 1367 (Colo. Ct. App. 1989); *Cronk I*, 765 P.2d at 619; Frampton v. Central Ind. Gas Co., 297 N.E.2d 425 (Ind. 1973); Nees v. Hocks, 536 P.2d 512 (Or. 1975).

107. Petitioner's Reply Brief at 13-16, Martin Marietta v. Lorenz, 823 P.2d 100 (Colo. 1992) (No. 90 SC 583). Martin Marietta claimed that Lorenz offered no evidence that any of the statements Martin directed of him were "*factually* false," and that Lorenz's "self-serving . . . *opinion*" was that the work was inadequate. *Id.* at 15 (emphasis in original).

108. 706 F.2d 1092 (11th Cir. 1983).

109. 320 F.2d 898 (2d Cir. 1963).

110. 498 N.E.2d 575 (Ill. App. Ct. 1986).

111. *Lorenz*, 823 P.2d at 111; *supra* note 96 (text of 18 U.S.C. § 1001). The *Lorenz* court relied on *Diogo*, where the Second Circuit found 18 U.S.C. § 1001 to contain two distinct offenses: (1) concealment of a material fact; and (2) false representation, in which "both offenses may be the same, to create or foster on the part of a Government agency a misapprehension of the true state of affairs." *Diogo*, 320 F.2d at 901-02.

The *Lorenz* court also adopted the interpretation of 18 U.S.C. § 1001 in *Johnson*, which declared the purpose behind 18 U.S.C. § 1001 as "establish[ing] a clearly mandated public policy against deceptive practices aimed at frustrating or impeding legitimate functions of government departments or agencies." *Johnson*, 498 N.E.2d at 577-78. For Tenth Circuit interpretations of this statute and its criminal elements and proof, which is beyond the scope of this Comment, see United States v. Jones, 933 F.2d 807 (10th Cir. 1991); United States v. Daily, 921 F.2d 994 (10th Cir. 1990), *cert. denied*, 112 S. Ct. 405 (1991); United States v. Irwin, 654 F.2d 671 (10th Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982). *See also* United States v. Gilliland, 312 U.S. 86 (1941) (interpreting the purpose prior to codification of the Act of June 25, 1948).

112. *Lorenz*, 823 P.2d at 116-20 (Erickson, J., concurring in part and dissenting in part).

with the court's newly pronounced standards.[113]

## IV. ANALYSIS

### A. *Unanswered Questions*

Although Colorado has now joined the majority of jurisdictions[114] in adopting the public policy exception in tort to the at-will employment doctrine, new questions arise. The *Lorenz* court provided little guidance as to what will satisfy the additional causation element of employer knowledge in the newly recognized common law tort. Proving the first five elements of a *prima facie* case under the *Cronk I* standard[115] as adopted by the *Lorenz* court, will implicitly prove the employer knowledge element. Yet the *Lorenz* court added a "*mens rea*" requirement of employer knowledge in a civil action.[116] A wrongfully discharged employee must show that his employer *knew,* or *should have known,* that the reason the employee refused to comply with the employer's order was due to the employee's reasonable belief that the act directed by the employer was illegal, statutorily protected activity, or in clear contravention of public policy relating to an employee's rights or privileges.[117] It is unclear whether these enumerations are exclusive, or whether "the public policy exception encompass[es] an employee's 'whistleblowing' activity or other conduct exposing the employer's wrongdoing[.]"[118]

These questions are only partially answered by judicial opinions subsequent to the *Lorenz* decision. Attorneys, to date, have no clear and accurate precedent to determine what evidence sufficiently meets the ad-

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The intent behind this Comment is a discussion and survey of the public policy exception to the employment at-will doctrine, and how Colorado may be affected by the *Lorenz* decision. Because the court was split only on the issue of retroactive application of the new standard, and also because of the limitations in the scope of this writing, the issues of retroactive application and running of the statute of limitations will not be analyzed.

The underlying issue behind the dissent was whether the newly adopted standard should apply to the parties before the court, as well as those on the docket for appeal. The dissent claimed that the standard in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), for determining whether a judicial decision should be applied retroactively, was improperly applied by the majority. *Lorenz*, 823 P.2d at 117-20.

113. *Supra* notes 5-6. The court also unanimously agreed that the statute of limitations did not begin to run on a tort wrongful discharge claim until the employee had been injured by being separated from his employment. *Lorenz*, 823 P.2d at 115-16; *supra* notes 92-94 & 112.

114. *Lorenz*, 823 P.2d at 108. For a state-by-state comparison chart of the status of at-will employment see 9A Lab. Rel. Rep. (BNA) 505:51-52 (July, 1992).

115. *See supra* note 5 and accompanying text.

116. 823 P.2d at 108-10. The court calls the added element an "additional evidentiary requirement." *Id.* at 110. While this may indeed be an additional evidentiary requirement, it also acts as a *mens rea* requirement of the employer's state of mind.

117. *Id.*

118. Outline of Gilbert M. Román, Esq., *Tort of Wrongful Discharge Against Public Policy in Colorado*, at 6, used for a National Employment Lawyers Association [NELA] meeting (April 24, 1992) and as part of the materials accompanying a Colorado Trial Lawyers Association ("CTLA") CLE seminar, "Hot Topics in Employment Law" (Nov. 20, 1992), section contributed by Darold W. Killmer, Esq., *Developments in the Common Law of Colorado* (on file with author). Mr. Killmer is a partner, and Mr. Román currently practices with Feiger, Collison & Killmer, in Denver, Colo. The author wishes to thank Mr. Killmer, Mr. Román, and Feiger, Collison & Killmer for their generous assistance.

ded element of employer knowledge of the employee's reasonable belief of illegality, or how the courts will construe the language set forth in *Lorenz*.[119] This section of the Comment will focus on the employer knowledge requirement in *Lorenz* as it has been interpreted by subsequent courts, what additional case law may apply to satisfy the element, and parallel legislative means of controlling wrongful discharge and whistleblowing.

The *Lorenz* court reasoned that the additional evidentiary element will result in providing the employer an opportunity to distinguish between conscientious employees truly concerned about the legality of their employer's directive, and merely subordinate employees.[120] The court further declared that the employer knowledge element provides the employer with fair notice, prior to making a termination decision, of the circumstances supporting the employee's reasonable belief that the directed act was wrongful, against public policy, or prohibiting the employee's rights or lawful privileges.[121] In recognizing a tort cause of action for wrongful discharge with an additional scienter element, the court rationalized the *Lorenz* decision as not only limiting the employer's discretion in discharging at-will employees, but also as (1) accommodating the employer's interest in worker efficiency and loyalty; (2) accommodating the employee's interest in not being coerced into having to choose between almost certain termination of employment or engaging in illegal conduct or conduct contrary to the employee's civic rights and duties; and, (3) society's interest in maintaining a balance between the two.[122]

The goals of the *Lorenz* court are relevant to today's less than satisfactory economic situation, and the ever-increasing big business control

119. Román, *supra* note 118, at 4. This requirement means that, if nothing else, Colorado plaintiff's lawyers can predict an additional hurdle in proving a *prima facie* case of wrongful discharge in tort in relation to the public policy exception to at-will employment. *Lorenz* is "not a model of clarity," leaving open other questions. For example, what types of cases may arise under the claim of "wrongful discharge" out of the nearly infinite possibilities? Is an employee protected under *Lorenz* for merely opposing her employer's wrongdoing without the protection of a specific statute or enumerated public policy? Darold W. Killmer, Esq., Remarks at CTLA Seminar: "Hot Topics in Employment Law" (Nov. 20, 1992).

The *Lorenz* court conceded that this evidentiary requirement will place on the employee an extra "burden" not articulated in *Cronk I*, but claimed that the added element will "not alter in a fundamental way the basic nature of the tort claim for wrongful discharge outlined in the *Cronk [I]* decision." *Lorenz*, 823 P.2d at 110. The court did not state any reasoning to show this extra requirement as beneficial to the public, excluding employers, or to the wrongfully discharged employee, who is already suffering an economic loss.

Martin Marietta, on the other hand, feared that recognizing a public policy exception to at-will employment would result in an "insubordinate employee [who] could *hold management hostage* by immediately threatening a claim under the generality of many statutes, leaving management to choose between maintaining industrial discipline and predicting how a jury might apply the statute." Brief for Petitioner at 27, Martin Marietta Corp. v. Lorenz, 823 P.2d 100 (Colo. 1992) (No. 90 SC 583) (emphasis added).

120. *Lorenz*, 823 P.2d at 110.

121. *Id.*

122. *Id.* It is interesting to note that the *Pierce* public policy definition, *supra* note 20, seems to appear in *Lorenz*.

over much of the population's everyday lives and careers. The court, however, potentially biased its own public policy decision in favor of employers by making the causation elements in a retaliatory discharge under the public policy exception more difficult to establish (at first glance) in Colorado than in other jurisdictions recognizing the exception.[123] The *Lorenz* court further complicated the legal analysis by declaring the public policy exception a tort action, yet including contract principles as part of the rationale that public policy exceptions sound in tort.[124]

In employment cases, the element of employer knowledge is also closely related to the proximity in time between the employee's refusal to act or participation in a statutorily protected activity and the time of the employee's discharge, and the burden of proving causation. If one looks only for state case law (and federal case law interpreting state law) duplicating the *Lorenz* court's specific employer knowledge element, little will be found.[125] Analogies are plentiful, however, if one examines other jurisdictions' interpretation and causation analyses of similar fact patterns, federal and state wrongful discharge statutes, and whistleblowing statutes. Many of these either expressly or implicitly require employer knowledge.[126] To make the connection between the *Lorenz* court's "public policy exception" and "whistleblowing," one must embrace the view that, in effect, they are one and the same; both falling under the broader common law category of "retaliatory discharge." The difference is a matter of semantics.

### B. *Terminology and Plausible Implications*

Under the broad category of common law wrongful discharge both contract and tort actions exist.[127] Retaliatory discharge is synonymous with wrongful discharge. Both are synonymous with the public policy exception to the at-will employment rule, and it may be argued that the term "whistleblower" is likewise synonymous with all of these terms.[128]

123. *See Lorenz*, 823 P.2d at 118 n.1 (Erickson, J., dissenting) (noting that "the majority cites no authority for requiring employer knowledge of an employee's reasonable belief that a refused order was illegal").

124. *Id.* at 109. *See supra* notes 104-06 and accompanying text. The court rationalized that since Colorado has a long-standing rule that contracts violative of public policy are unenforceable, it is "axiomatic" that contractual terms in employment, such as "at-will," should "be deemed unenforceable when violative of public policy." *Lorenz*, 823 P.2d at 109. The court does not expand on or define their use of the word "axiomatic." The court seems to presume this particular relationship between contract and tort employment law to be so evident that no additional proof or reasoning is required. That is a debatable issue beyond the scope of this Comment.

125. *See infra* notes 145-59 and accompanying text.

126. *See infra* notes 160-83 and accompanying text.

127. *See* 9A Lab. Rel. Rep. (BNA) 505:51-52 (July, 1992) (state-by-state comparison chart illustrating which states recognize the contract action, which states recognize the tort action, which states recognize both, and which states recognize neither).

128. *See* Callahan, *supra* note 20, at 485 n.26 (using the terms "public policy exception claim," "wrongful discharge," and "retaliatory discharge" interchangeably); *see also* BLACK'S LAW DICTIONARY 1612-13 (6th ed. 1990) (defining "wrongful discharge" as "an at-will employee's cause of action against his former employer, alleging that his discharge

Both "retaliatory discharge" and "whistleblowing," if proven, infer a motive of the employer's desire to "get even" with the employee for the employee's words, acts, refusals or omissions to act. Yet, pursuant to the at-will employment rule, such retaliatory behavior by the employer is only actionable by the employee when a public policy exception to the at-will rule exists.[129] The synonymous relationship among the terms "public policy exception," "wrongful discharge," "retaliatory discharge," and "whistleblowing" is further supported in the facts of the *Lorenz* case.[130]

Lorenz's refusals to (1) falsify reports to NASA, and his subsequent disclosure to NASA of Martin Marietta's directive to him to change conference minutes; (2) participate in Martin Marietta's scheme to misapply NASA appropriations; and (3) submit to inadequate testing of Space Shuttle components easily fall within the accepted definitions of all four previously discussed terms. First, providing that Lorenz proves each *prima facie* element of the tort as set out in *Lorenz*, an action exists as a "wrongful" or "retaliatory discharge." Second, Lorenz's refusal to inaccurately modify conference minutes and his subsequent disclosure of his dispute with Martin Marietta to NASA, as well as Lorenz's allegation that Martin Marietta defrauded the United States in violation 18 U.S.C. § 1001[131] clearly fits the definition of a "whistleblower."[132] Finally, Lorenz's refusal to falsify reports to NASA, misapply NASA appropria-

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was in violation of state or federal anti-discrimination statutes, . . . public policy, . . . an implied employment contract, . . . or an implied covenant of good faith and fair dealing;" [with supplemental reference to "whistleblower acts"]); *Id.* at 1596 (defining "whistle blower" as "an employee who refuses to engage in and/or reports illegal or wrongful activities of his employer or fellow employees[;] . . . [e]mployer retaliation against whistle blowers is often statutorily prohibited" [with reference to "wrongful discharge"]); *Id.* at 463 (defining "constructive discharge" as occurring "when an employer *deliberately* makes an employee's working conditions so intolerable that the employee is forced into involuntary resignation.") (emphasis added); 9A Lab. Rel. Rep. (BNA) 505:21, 25-26 (May, 1987) (comparing federal and state whistleblower protection statutes, and comparing conflicting state case law decisions as to the inclusion of "whistleblowing" within the public policy exception).

Other definitions of "constructive discharge" besides that in BLACK'S LAW DICTIONARY, *supra*, are applicable. COLO. CIVIL JURY INSTRUCTIONS 3d § 31:8 (Cum. Supp. 1993), defines "constructive discharge" as occurring when "an employer deliberately makes or allows an employee's working conditions to become so intolerable that the employee has no reasonable choice but to quit or resign and the employee does quit or resign because of those conditions," based upon a reasonable person standard. Other jurisdictions have recognized the legal possibility of constructive discharge. *See, e.g.*, Sterling Drug, Inc., v. Oxford, 743 S.W.2d 380 (Ark. 1988); Garcia v. Rockwell Int'l Corp., 232 Cal. Rptr. 490 (Cal. Ct. App. 1987) (factually similar to the *Lorenz* case); Seery v. Yale-New Haven Hosp., 554 A.2d 757 (Conn. App. Ct. 1989).

For a detailed treatment on the definition of "whistleblowing," see James N. Adler & Mark Daniels, *Managing the Whistleblowing Employee*, 8 LAB. LAW. 19, 21 & n.8 (1992). Adler and Daniels define whistleblowing as "an elusive concept" that includes an employee's (1) opposition internally or externally to their employer's conduct; (2) refusal to commit an illegal act for the employer; (3) reporting a perceived impropriety to the supervisor, governmental agency or media; or (4) bringing an action against the employer alleging the employer submitted false claims to the government. *Id.*

129. Each jurisdiction has their own definition of public policy. *See supra* note 20.

130. *See supra* notes 73-92 and accompanying text.

131. *See supra* note 96.

132. *See supra* note 128.

tions, and participate in inadequate testing clearly fit the *Lorenz* definition of the public policy exception, as these acts force Lorenz to choose between committing an illegal act or losing his job. Furthermore, Lorenz was directed to inadequately test Space Shuttle components, paid for by taxpayers, which would be trusted with the lives of astronauts who, presumably, do not know of the inadequate testing. In light of the Space Shuttle "Challenger" tragedy, it is difficult to describe a public policy more compelling than the protection of human lives.[133]

If one accepts the view that "public policy exceptions," "whistleblowing," "wrongful discharge" and "retaliatory discharge" are synonymous, and therefore are all really the same cause of action in tort, it is but one short step further to infer that any *prima facie* case of retaliatory discharge under the *Lorenz* standard inherently implies employer knowledge if the first five elements in *Lorenz* have been shown.[134] Once the employee, by a preponderance of the evidence, shows the first five *Lorenz* elements, the sixth employer knowledge element will be satisfied by implication. An analysis of the first five individual elements in the *Lorenz* standard reveals the inherent employer scienter element.

Using the *Lorenz* fact pattern, when Lorenz was directed by Martin Marietta to approve inadequate component testing, participate in a project in which NASA funds were misappropriated, and materially change the contents of official minutes of a meeting in which NASA addressed Lorenz's personal complaints of wrongdoing,[135] the first four *Lorenz* elements were satisfied.[136] Lorenz successfully showed that he refused to do something ordered by Martin Marietta which would be either against the law or against public policy. The fifth *Lorenz* element, termination of employment for refusing the employer's directive (retaliation), was satisfied when Lorenz was laid-off shortly after refusing to write the final evaluation report endorsing the Tug-Irad project.[137] At this point, the *prima facie* case is complete because the retaliation has been shown. By showing the employer's retaliation, the employee has also shown the implicit scienter element. No *prima facie* case will occur if the ordered act is not against a specific statute or a clear public policy. Realistically, how can an employer retaliate against an employee without *knowing* or *believing* the employee to have committed an act against the employer's interest, or that the employee refused to act in favor of the employer's interest? Retaliation simply cannot "exist" in the absence of a *reason* to retaliate.

Thus, since the *Lorenz* employer knowledge element is inherent within the first five *Lorenz* elements of a *prima facie* retaliatory discharge, there is no need for a separate employer knowledge element. In effect, the additional scienter element added by the *Lorenz* court is unneces-

133. *See supra* note 20 for public policy definitions.

134. *See Lorenz*, 823 P.2d at 109. *See supra* text accompanying note 103.

135. *See supra* notes 73-92 and accompanying text (factual summary of the *Lorenz* case).

136. *See supra* text accompanying note 103 (the *Lorenz* elements).

137. *See supra* text accompanying notes 90-92.

sary.[138] Cases subsequent to *Lorenz*, other jurisdictions' case law, and federal and state legislation may now be examined in a different light when the issue of causation is compared to the *Lorenz* standard. A Colorado plaintiff's attorney may find more persuasive authority available than a first impression would otherwise indicate.

### C. *Cases Subsequent to Martin Marietta v. Lorenz*

The first Colorado appellate decision[139] to use the *Lorenz* standard with the additional employer knowledge element was the appeal after remand of *Cronk I*.[140] The Colorado Court of Appeals in *Cronk II*, adopted the *Lorenz* standard and applied the additional employer knowledge element.[141] The *Cronk II* decision identified *Lorenz* as a case contemplating explicit employer directives. Conversely, expanding on the *Lorenz* standard, the *Cronk II* court concluded that *Lorenz* "also embraces situations in which an employee is so directed *implicitly*, resulting in a retaliatory termination."[142]

The employer in *Cronk II* contended that the *Lorenz* standard had not been met because the employees were not directed to violate the law, nor were they fired for refusing to violate any law or public policy.[143] The employer also alleged that the "actual or constructive [employer] knowledge" element set out in *Lorenz*[144] had not been met by the employees.[145] The former employees countered that (1) they had a statutory duty to oppose their employer's intentional concealment of

138. From a non-legal perspective, the additional evidentiary requirement of employer knowledge equates to proving: "I know that you know that I know." If, of course, the employee fails to show evidence of a *prima facie* case, the employee is nothing more than an out-of-luck and out-of-court former at-will employee. If the employee cannot prove "wrongfulness" on the part of the employer in discharging the employee (retaliation), then the employer knowledge element is irrelevant.

Support for the theory that the employer knowledge element is inherent when the employer's retaliation is proven may be found in *Cronk II*, *see infra* notes 140-48 and accompanying text. *See also* Melchi v. Burns Int'l Sec. Serv., Inc., 597 F. Supp. 575, 582 (E.D. Mich. 1984) (the employer knowledge element is "simply a factor to consider in determining the principal question of causation").

139. *Cronk II* is the only Colorado appellate decision, to date, to use the *Lorenz* standard. At least one Colorado district court has adopted and applied the *Lorenz* standard. *See* Stuart v. St. Anthony Hosp. Systems, No. 91 CV 2809, slip op. 2-3 (Denver Dist. Ct. Feb. 21, 1992) (applying the *Lorenz* standard, and finding issues of fact existed as to whether the employee was discharged in retaliation for reporting specific violations of both statutes and regulations concerning medication disbursement, patient privacy, and mandatory emergency procedures) (emphasis added); Román, *supra* note 118, at 6.

140. *Cronk I*, 765 P.2d at 622. *See supra* notes 54-56 and accompanying text.

141. *Cronk II*, 140 L.R.R.M. at 2153.

142. *Id.* (emphasis added).

143. Supplemental Brief for Appellant at 2-4, *Cronk II* (No. 90 CA 0666).

144. *Lorenz*, 823 P.2d at 102.

145. Supplemental Brief for Appellant at 4-5, *Cronk II* (No. 90 CA 0666). The employer alleged that the *Cronk I* and *Lorenz* courts "wisely chose to limit such claims to those brought by employees with a *direct stake* in an issue, who *presumably are knowledgeable* of the circumstances and *in a position to assess the validity of their employer's actions*." *Id.* (emphasis added). This represents an extreme interpretation of the use of the terms "actual or constructive knowledge" quoted from *Lorenz*. "Constructive knowledge" is defined as: "[i]f one by exercise of reasonable care would have known a fact, he is deemed to have had constructive knowledge of such fact." BLACKS LAW DICTIONARY 314 (6th ed. 1990).

public utility statute and safety violations; (2) they refused to aid and abet these illegal practices by their employer; and (3) they were fired in retaliation for refusing to conceal these illegal practices.[146] The employees further alleged that the employer knowledge element was satisfied because the jury was required to find that the employees' exercise of a statutorily protected right or duty be a substantial or a motivating factor in the employer's decision to discharge the employees.[147] Thus, employer awareness was *implied* because "the jury could not have found that the [employees] were discharged for opposing illegal acts *without* finding that the [employers] knew they were opposing illegal acts."[148]

The *Cronk II* court agreed with the former employees, affirming the trial court jury verdicts finding that the employees' exercise of statutory duties were implicitly prohibited by the employer, thereby "comporting" with the *Lorenz* standard.[149] The *Cronk II* court concluded that the *Lorenz* employer knowledge element was satisfied because "the jury was required to consider and find that [the employer] knew or should have known that [the employees] opposed [the employer's] practices because they believed that such conduct was illegal."[150] The three former employees were each awarded an average of $535,580.00 in economic damages, punitive damages and pre-judgment interest.[151]

The United States Court of Appeals for the Tenth Circuit recently adopted the *Lorenz* standard, including the employer knowledge element, in *Mares v. Conagra Poultry Co.*[152] The employer knowledge element was not applied by the court, however, because the employee never contended that the employer's drug testing policy was illegal, but instead objected to filling out an accompanying medical form.[153]

### D. *Applicable Case Law From Other Jurisdictions*

Few decisions from other jurisdictions dealing with the public policy exception "give explicit consideration to the elements of the claim,"

146. Supplemental Brief for Plaintiff-Appellees at 2-3 nn.2-5, *Cronk II* (No. 90 CA 0666). Many of the former employees' allegations were supported in the record, and Plaintiff Cronk was discharged "just two days after the [Public Utilities Commission] announced publicly it was going to investigate [the employer] for illegal activity," thus inferring that the time interval regarding Cronk's discharge *implied* retaliation. *Id.* at 2 n.4.

147. *Id.* at 4-5.

148. *Id.* at 5 (emphasis in original).

149. *Cronk II*, 140 L.R.R.M. at 2153.

150. *Id.*

151. *Id.* at 2150. For a discussion on high jury verdicts, see *supra* note 9.

152. 971 F.2d 492, 495-96 (10th Cir. 1992); *see supra* notes 62-67 and accompanying text. In another recent case, the *Lorenz* standard was adopted, but the employer knowledge issue was precluded by the granting of the employer's motion for summary judgment. Meehan v. Amax Oil & Gas, Inc., 796 F. Supp. 461, 468 (D. Colo. 1992) (granting the employer's summary judgment motion because the employee was never directed to act in a certain way, never prohibited from exercising a job-related right or privilege, and did not support his allegation that his discharge violated a clearly expressed public policy, but instead articulated only a generalized public policy). *See also* Lampe v. Presbyterian Med. Ctr., 590 P.2d 513 (Colo. Ct. App. 1978) (broad, general statements of public policy held inadequate to state a cause of action).

153. *Mares*, 971 F.2d at 496.

or "address the allocation of the burden of proof."[154] In the few opinions discussing the appropriate elements at common law, as few as one, to as many as six elements (as in the *Lorenz* case), are described with very little consistency in the approaches taken.[155] One commentator has

154. Callahan, *supra* note 20, at 488. Normally, the employee will have the burden of proving a *prima facie* case, and the employer will have the risk of nonpersuasion in cases where there is a factual dispute over the employer's motive in discharging the employee. *Id.* at 507-12 (cases involving "employer pretext" or "mixed motives). In situations where the termination is alleged by the employer to be unrelated to the employee's protected acts or refusal to act, or the employer's reasons for discharge are enumerated in statutes as exceptions, a "mixed-motive" situation exists. *Id.* Ordinarily, following the employee's prima facie case, the burden shifts to the employer to show that the "same decision" would have been made notwithstanding the employee's protected activity. At this point many courts will allow a shift back to the employee (who maintains at all times the ultimate burden of persuasion) to show that the employer's proffered reason was "mere pretext." *Id.* Employment discrimination cases are, however, "arguably distinguishable from public policy exception cases because most terminations litigated pursuant to that statute are . . . based on [the plaintiff's] membership in a protected class, as opposed to protected conduct." *Id.* at 484 n.19.

The United States Supreme Court has set out a skeletal framework for discrimination cases. *See* Texas Dep't of Community Affairs v. Burdine, 450 U.S. 248, 253, 256 (1981) (in an employment discrimination case the employee retains the ultimate burden of persuading the trier of fact that the employer intentionally discriminated against her, and that the employer's proffered reason was pretext), *explaining and modifying* McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802-05 (1973) (in a discrimination case the employee has the initial burden of establishing a *prima facie* case of discrimination; the burden then shifts to the employer to "articulate some legitimate, nondiscriminatory reason for the employee's rejection;" and the employee again bears the burden to prove that the employer's reason for rejection was a "cover-up," or pretextual).

The federal and state courts have not, however, been consistent in the application of the employment discrimination burden shifting in retaliatory discharge cases. *Compare* Trujillo v. Grand Junction Regional Ctr., 928 F.2d 973 (10th Cir. 1991) (following *Burdine* and *McDonnell Douglas*) *with* Swearingen v. Owens-Corning Fiberglas Corp., 968 F.2d 559, 562 (5th Cir. 1992) (one shift; employee bears the initial burden of establishing a causal link between the discharge and the protected activity [worker's compensation claim], which need only be proof that the employee's protected activity was a "determining factor" and not necessarily the sole factor in the discharge; the burden then shifts to the employer who then must rebut this presumption by showing a legitimate reason for the discharge).

State decisions also reflect a variety of burden-shifting analyses as applied to the causation element in the common-law public policy exception in tort. *See, e.g.*, Parnar v. Americana Hotels, Inc., 652 P.2d 625, 631 (Haw. 1982) (employee alleging retaliatory discharge bears the burden of proving that the discharge violates a clear mandate of public policy); Sabine Pilot Serv., Inc., v. Hauck, 687 S.W.2d 733, 736 (Tex. 1985) (employee has burden of proof and persuasion; the fact finder decides if the employer sought to have the employee commit an illegal act); Thompson v. St. Regis Paper Co., 685 P.2d 1081, 1089 (Wash. 1984) (employee has the burden of proving his dismissal violates a clear mandate of public policy; burden shifts to the employer to prove that the dismissal was for reasons other than those alleged by the employee); Brockmeyer v. Dun & Bradstreet, 335 N.W.2d 834, 840-41 (Wis. 1983) (employee has the initial burden of proving that the dismissal violates a clear mandate of public policy; the burden shifts to the employer to prove that the dismissal was for just cause). For a detailed discussion of burdens, shifts of burdens and employer "privileges," see Callahan, *supra* note 20, at 507-14.

155. Callahan, *supra* note 20, at 488-89 nn.39-42. *See, e.g.*, Kennard v. Louis Zimmer Communications, Inc., 632 F. Supp. 635, 638 (E.D. Pa. 1986) (one element: *prima facie* case made when employee proves the discharge was for conduct protected by the public policy of the state); Sherman v. St. Barnabas Hosp., 535 F. Supp. 564, 571 (S.D.N.Y. 1982) (two elements: the employee must establish that (1) a public policy of the state of New York exists, (2) which was violated by the employer); Hinthorn v. Roland's of Bloomington, Inc., 519 N.E.2d 909, 911 (Ill. 1988) (three elements: (1) the employee must show a discharge occurred; (2) the discharge was in retaliation for her activities; and (3) that the

proposed that when an employee is discharged for exercising a statutory right or public duty, refusing to participate in wrongful or illegal activity, or "blowing the whistle" on others' harmful conduct, few distinctions are necessary between these categories.[156] Rather, the following elements are suggested: (1) an act or refusal to act by the employee; (2) which was supported by public policy, (3) bearing a causal relationship to (4) the employee's discharge.[157] The element of causation, then, appears central to understanding the employer knowledge and temporal elements. Because "an employer cannot fire an employee in retaliation for actions of which the employer is unaware," the employee, in proving a causal relationship, "must show that the employer was aware of the act or refusal to act in question prior to the discharge," and relate this to the temporal proximity of the employee's act or refusal to act, and the subsequent discharge.[158]

Although there is a dearth of case law explicitly saying so, it is reasonable to find that when an employee is discharged almost immediately after the employer becomes aware of the employee's act or refusal to act, a retaliatory motive may reasonably be inferred. The chain of causation is relatively short, and often blatant. First, the employee does or says something (or refuses same) that the employee perceives is illegal or clearly violative of "public policy."[159] Next, the employer finds out (awareness of the act *must* occur for retaliation), and, after what is often a short duration of time, the employee is either discharged, psychologically pressured by supervisors and peers to quit, or simply "laid-off." When the fact-finder determines retaliation has occurred, a demonstrable interrelationship to societal concerns must be shown, which should

discharge violated a clear mandate of Illinois public policy); Hicks v. Resolution Trust Corp., 970 F.2d 378, 381 (7th Cir. 1992) (same); *Cronk I*, 765 P.2d at 622 (five elements: the employee must prove (1) that he refused to perform an action, (2) ordered by his employer, (3) which would violate a specific statute, (4) whose terms are more than a broad general statement of policy, and (5) that his termination resulted from his refusal); *Lorenz*, 823 P.2d at 109 (six elements).

156. Callahan, *supra* note 20, at 490.

157. *Id.*

158. *Id.* at 497-98. Callahan notes that evaluation of the timing of the employee's act or refusal to act, and the employer's response (discharge or constructive discharge) "is highly relevant to the characterization of a possible connection between them." *Id.* at 498. One recent common-law decision combines these two elements in a retaliatory discharge action under the "whistleblowing" label. *See* Winters v. Houston Chronicle Publishing Co., 795 S.W. 2d 723, 732-33 (Tex. 1990) (to establish causation, the employee must demonstrate that (1) the employer had knowledge of the whistleblowing prior to the retaliation; (2) the discharge must be shown to have occurred within a reasonably short time after one or more complaints were lodged; and (3) the burden then shifts to the employer to refute the causation element by proving dismissal occurred for reasons other than the act of whistleblowing).

For examples of cases referring to the temporal element, see Hamann v. Gates Chevrolet, Inc., 910 F.2d 1417, 1420 (7th Cir. 1990) (employee failed to prove relevant timing between her refusal to act and her discharge, despite the court's recognition that rapidity and proximity in time between refusal and discharge, when considered with other circumstances, may create the necessary inference of the employer's prohibited motive); House v. Carter-Wallace, Inc., 556 A.2d 353, 357-58 (N.J. Super. Ct. App. Div. 1989) (three month interval between the employee's whistleblowing activity and discharge prevented inference of retaliatory motive). *See supra* note 138.

159. *See supra* note 20.

be given superior weight in the balancing process.[160]

As the following cases demonstrate, some authority exists supporting an employer knowledge element within a *prima facie* case of retaliatory discharge. While *Mares v. Conagra Poultry Co.*[161] follows *Lorenz*, two Tenth Circuit cases pre-dating *Lorenz* required employer knowledge as proof of causation. In *White v. American Airlines, Inc.*, an employee was discharged for refusing to commit perjury in litigation that followed the disastrous 1979 crash of an American Airlines DC-10 jetliner over Chicago's O'Hare Airport.[162] The court held that jury instructions which included a required finding that the employer knew of the employee's refusal to commit perjury prior to the employee's discharge sufficiently satisfied the causation requirement.[163] In *Stuart v. Beech Aircraft Corp.*,[164] the court applied Kansas precedent[165] and required employer knowledge in a whistleblowing case. In *Stuart*, the employee was required to prove by clear and convincing evidence that (1) a reasonable person would conclude that the employer was engaged in wrongful or illegal activity; (2) the employer had knowledge of the employee's act or refusal prior to discharge; (3) the employee was discharged in retaliation for such act or refusal; and (4) the employee's act or refusal was due to a good-faith concern about the employer's wrongful activity, and not out of spite.[166]

Prior to Colorado's wrongful discharge tort standard described in *Cronk I*,[167] and expanded by *Lorenz*,[168] the Kansas Supreme Court recognized the tort of retaliatory discharge in the whistleblowing case of *Palmer v. Brown*.[169] While the *Palmer* standard, like the *Lorenz* standard, is not a model of clarity, it does require clear and convincing evidence of the employee's good faith belief that the employer's activity was contrary to public policy or illegal, and that "the employer *had knowledge* of

160. Callahan, *supra* note 20, at 486-87.

161. 971 F.2d 492 (10th Cir. 1992).

162. 915 F.2d 1414, 1417 (10th Cir. 1990).

163. *Id.* at 1422. The *White* court affirmed the United States District Court for the Northern District of Oklahoma regarding instructions to the jury that included among the essential elements of wrongful discharge: (1) the employee was requested to commit perjury; (2) the employee refused to commit perjury and the employer *knew* of the employee's refusal; and (3) the employee was terminated because of his refusal to commit perjury. In order to find the employer liable, "the jury had to conclude that American *knew* about White's refusal to commit perjury and terminated his employment because of that refusal." *Id.* Further, the jury could find liability "only if the American officials responsible for [White's] termination were in fact *aware* that [White] refused to commit perjury." *Id.* (emphasis added).

164. 753 F. Supp. 317 (D. Kan. 1990), *aff'd*, 936 F.2d 584 (10th Cir. 1991).

165. *See* Palmer v. Brown, 752 P.2d 685, 690 (Kan. 1988).

166. *Stuart*, 753 F. Supp. at 324. *See also* Wolff v. Berkley Inc., 938 F.2d 100, 103 (8th Cir. 1991) (holding that "[i]n order to succeed on a claim for retaliatory discharge, the [employee] must prove a causal relationship between statutorily protected activity and her termination . . . [which] does not exist if the employer is not *aware* of the employee's statutorily protected activity") (emphasis added).

167. 765 P.2d 619 (Colo. Ct. App. 1988), *cert. denied, appeal after remand*, 140 L.R.R.M. (BNA) 2149 (Colo. Ct. App. 1992), *cert. denied* (*Cronk II*).

168. 823 P.2d 100 (Colo. 1992).

169. 752 P.2d 685, 690 (Kan. 1988). *Palmer* was decided in March, while *Cronk I* was decided in July.

the employee's reporting of such violation prior to discharge."[170] The *Palmer* standard requires clear and convincing evidence, rather than a "presentation" of evidence as in *Lorenz*.[171] *Palmer* was applied in *Pilcher v. Board of County Commissioners*,[172] in which the Kansas Court of Appeals interpreted the *Palmer* standard liberally by not limiting retaliatory discharge claims to violations of law pertaining to public health, safety, and the general welfare,[173] but instead indicated that First Amendment freedom of speech violations may support a whistleblowing retaliatory discharge claim.[174] These cases suggest the employer knowledge element

170. *Id.* at 690 (emphasis added). The *Palmer* standard provides that:

> To maintain such action, an employee has the burden of proving by clear and convincing evidence, under the facts of the case, a reasonably prudent person would have concluded the employee's co-worker or employer was engaged in activities in violation of rules, regulations, or the law pertaining to public health, safety, and the general welfare; the employer had knowledge of the employee's reporting of such violation prior to discharge of the employee; and the employee was discharged in retaliation for making the report. However, the whistleblowing must have been done out of a good faith concern over the wrongful activity reported rather than from a corrupt motive such as malice, spite, jealousy or personal gain.

*Id.*

171. *Lorenz*, 823 P.2d at 109.

172. 787 P.2d 1204, 1208-09 (Kan. Ct. App. 1990).

173. *Id.* at 1209. In *Pilcher*, the court ruled that the employee may be entitled to damages upon proof that her employer fired her because the employer believed the employee to be the source of an uncomplimentary newspaper article. *Id.* at 1208. The court also concluded that the employee, a public employee, was discharged in contravention of public policy when she was discharged for exercising her right to free speech, as long as her speech regarded a matter of public concern. *Id. See also* O'Sullivan v. Mallon, 390 A.2d 149, 150 (N.J. Super. Ct. Law Div. 1978) (dicta) ("There are many facts which would be pertinent . . . includ[ing] whether the [employer] knew or should have known the act in question was illegal, the extent of [the employee's] training and qualifications[,] . . . and generally, the reasonableness of the acts by all of the parties.").

Cases involving truck drivers who were discharged after reporting matters of safety offer analogous fact patterns to that in *Lorenz*, and although employer knowledge is not stated as an element in these common law tort actions, the employer's knowledge may easily be implied. *See, e.g.*, McClanahan v. Remington Freight Lines, Inc., 517 N.E.2d 390 (Ind. 1988) (at will truck driver stated a cause of action for wrongful discharge after he was terminated for refusing to illegally transport an overweight load); Pooler v. Maine Coal Prod., 532 A.2d 1026 (Me. 1987) (trucker failed to state a cause of action by not pointing to a violation of motor vehicle law, only a potential violation of law); Coman v. Thomas Mfg. Co., 381 S.E.2d 445 (N.C. 1989) (at-will trucker stated cause of action after he was terminated for refusing to operate his truck in violation of Dept. of Transportation regulations, and for refusing to falsify the logs of travel). *But see* Burrow v. Westinghouse Elec. Corp., 363 S.E.2d 215 (N.C. Ct. App. 1988) (at-will trucker failed to state a cause of action after being discharged for refusing to drive under allegedly unsafe conditions, because holding every discharge for failure to perform an allegedly unsafe act as actionable "would create a prolific and unwarranted source of trouble in the workplace"); *see also* Todd v. Frank's Tong Serv., Inc., 784 P.2d 47 (Okla. 1989) (former truck driver stated a cause of action when he was discharged for refusing to operate his truck in violation of Oklahoma statutes prohibiting operation of motor vehicles with defective brakes, headlights and turn signals).

174. *Pilcher*, 787 P.2d at 1208. *See* Mt. Healthy City Sch. Dist. Bd. of Educ. v. Doyle, 429 U.S. 274, 283, 287 (1977) (Supreme Court directed the district court on remand to apply the "same decision" test regarding whether an untenured schoolteacher was entitled to reinstatement due to denial of First Amendment rights by the school board in its decision not to rehire the teacher). *See supra* note 154 (brief discussion of burden-shifting).

The burden shifting test used in discrimination cases is an alternate type of causation test to that used in typical tort actions for wrongful discharge in state jurisdictions, but the respective results obtained are similar: the finding of discrimination or the finding of retal-

exists in several jurisdictions explicitly. They do not, however, provide a sound argument to counter the proposition that employer knowledge is inherent within a *prima facie* case of retaliatory discharge, and that most jurisdictions presumably treat such knowledge as implicit within the causation framework of a *prima facie* case of retaliatory termination.[175] Once retaliation is established, it is unnecessary to prove, as the *Lorenz* decision requires, that the employer knew or should have known of the employee's belief that the directed act was illegal, fraudulent or against clear public policy. An employer *must* know what she is retaliating against the employee for. Therefore, only the first five elements of the retaliation claim itself, as set out in *Cronk I*,[176] and modified in *Lorenz*,[177] need be proven by the employee.

Nevertheless, employment law attorneys cannot afford to overlook the employer knowledge element simply because it is implied in the causation analysis of a retaliatory discharge. This "additional evidentiary requirement"[178] of employer knowledge of the employee's belief that a directed act was illegal or contrary to clear public policy should not provide any unusual difficulties evidentially. Issues of hearsay should not present serious problems regarding proof of the employer's knowledge of the employee's act or refusal, and the subsequent retaliatory discharge. The employer's business records, reports and memoranda, or unusual absence thereof, made at or near the actual occurrence, by a person with knowledge, in the course of a regularly conducted business activity may disclose employer knowledge.[179] Likewise, depositions and interrogatories may be used to impeach inconsistent statements by witnesses or the employer.[180] Because employer knowledge is a required element of Colorado's common law tort of retaliatory discharge, hearsay as to the employer's state of mind and motive is admissible.[181] Moreover, well prepared cross-examination will also bring out employer knowledge which may have otherwise remained undisclosed.[182]

### E. *Legislation*

One solution to this common law problem may lie in legislation containing specific definitions of protected (employee) and prohibited (employer) conduct. Federal discrimination and whistleblowing legislation is broad in diversity, yet at the same time limited in coverage to

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iation. Many times both are present in a successful and well pleaded plaintiff's case. Thus, some valuable analogies exist in federal discrimination cases which may prove influential in state common law wrongful discharge actions.

175. Retaliatory termination, as a term of art, should include the legal and semantic synonyms, "wrongful discharge," "whistleblowing," and "public policy exceptions" to the at-will employment doctrine. *See* Callahan, *supra* note 20, at 485 n.26. *See supra* notes 127-138 and accompanying text.

176. *Cronk I*, 765 P.2d at 622.

177. *Lorenz*, 823 P.2d at 109.

178. *Id.* at 110.

179. COLO. R. EVID. 803(6) & 803(7).

180. COLO. R. EVID. 801(d)(1) & 801(d)(2).

181. COLO. R. EVID. 803(3).

182. *See, e.g.*, 7 AM. JUR. 2D *Proof of Facts* §§ 10, 20, 24-26 (1975 & Supp. 1992).

specialized or protected classes. The employee who is *not* in a recognized class or represented by a union has analogous federal law only as secondary authority.[183] While federal "whistleblowing" statutes may

183. *See* Callahan, *supra* note 20, at 484 & n.19. Callahan notes that termination is a common element between federal statutes which provides "useful insights" in reasoning, but is distinguishable because common law wrongful discharge involves litigation generally based on protected conduct rather than membership in a protected class. *Id.*

Adler & Daniels, *supra* note 128, at 23 & n.16, have collected (for the convenience of those doing such research) a list, augmented in this Comment, of federal statutes which protect employees who report violations from employer retaliation under the following federal legislation. These statutes include: Government Employee Rights Act of 1991, 2 U.S.C. § 1212 (Supp. III 1991) (unlawful employment practices include any intimidation of, or reprisal against, employees of the Senate by any Member, or an employee of the Architect of the Capitol by the Architect of the Capitol, because of the employee's exercise of a right under this Act); Whistleblower Protection Act of 1989, 5 U.S.C. §§ 1201-1222 (1988 & Supp. III 1991) (providing protection to certain federal employees who disclose information regarding government mismanagement, fraud, violations or dangers to the public); Civil Service Reform Act of 1978, 5 U.S.C. § 2301 (1988 & Supp. III 1991) (for "whistleblowing" civil service employees disclosing agency violations, fraud, gross mismanagement or dangers to the public); Department of Defense Authorization Act of 1984, 10 U.S.C. § 1587 (1988) (for disclosures by civilian employees); Department of Defense Authorization Act of 1987, 10 U.S.C. § 2409 (1988) (for disclosures by employees of defense contractors); Toxic Substances Control Act, 15 U.S.C. § 2622 (1991) (for commencing or participating in a proceeding); Asbestos Hazard Emergency Response Act of 1986, 15 U.S.C. § 2651 (1988) (for reporting asbestos in schools); Asbestos School Hazard Detection and Control Act of 1980, 20 U.S.C. § 3608 (1988) (for school employees publicizing an asbestos problem); Jurors' Employment Protection Act, 28 U.S.C. §§ 1861-1878 (1991) (for federal jury service); National Labor Relations Act, 29 U.S.C. §§ 151-169 (1988) (for filing or participating in a proceeding); Fair Labor Standards Act of 1938, 29 U.S.C. § 215(a)(3) (1988) (filing or participation in proceedings); Age Discrimination in Employment Act, 29 U.S.C. § 623 (1988 & Supp. II 1990) (for participating in proceedings); Occupational Safety and Health Act, 29 U.S.C. §§ 651-678 (1988) (for filing or participating in a proceeding); Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1140-1141 (1988) (for providing information or participating in proceedings); Migrant, Seasonal and Agricultural Worker Protection Act, 29 U.S.C. §§ 1801-1872 (1991) (for exercising rights pursuant to § 1855); Federal Mine Safety and Health Act of 1977, 30 U.S.C. § 815(c) (1988) (for commencing or participating in proceedings); Surface Mining Control and Reclamation Act, 30 U.S.C. § 1293 (1991) (for filing or participation in a proceeding); False Claims Act, 31 U.S.C. §§ 3730-3733 (1988 & Supp. II 1990) (for employees disclosing false claims or participating in proceedings); Longshoremen's & Harbor Workers' Compensation Act, 33 U.S.C. §§ 901-950 (1991) (for filing or participating in a proceeding); Federal Water Pollution Control Act, 33 U.S.C. § 1367 (1988) (for commencing or participating in a proceeding); Public Health Service Act, 42 U.S.C. §§ 201-300z-10 (1991) (for refusal to participate in sterilization, abortion or research on religious or moral grounds); Safe Drinking Water Act, 42 U.S.C. § 300j-309 (1991) (for commencing or participating in a proceeding); Equal Employment Opportunity Act [Title VII of the Civil Rights Act of 1964], 42 U.S.C. § 2000e-2003 (1988) (for employee opposition and for participation in proceedings); Energy Reorganization Act of 1974, 42 U.S.C. § 5851 (1988) (for participating in proceedings); Solid Waste Disposal Act, 42 U.S.C. § 6971 (1991) (for commencing or participating in a proceeding); Clean Air Act, 42 U.S.C. § 7622 (1988) (for participating in proceedings); Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. § 9610 (1988) (for providing information or participating in proceedings); Federal Employers' Liability Act, 45 U.S.C. § 60 (1988) (for providing information regarding the death or injury of an employee); Railroad Safety Authorization Act of 1978, 45 U.S.C. § 441(a) (1991) (for complaining, participating in a proceeding, or refusing to work under hazardous conditions); International Safe Containers Act, 46 U.S.C. §§ 1501-1508 (1991) (for reporting of unsafe containers); Surface Transportation Assistance Act of 1978, 49 U.S.C. § 2305 (1991) (for refusing to operate an unsafe vehicle, complaining, or participating in a proceeding).

For more information on federal statutes, see DONALD W. BRODIE, INDIVIDUAL EMPLOYMENT DISPUTES: DEFINITE AND INDEFINITE TERM CONTRACTS 231-40 (1991); Peck,

not answer questions concerning state common law tort causation, a few analogies are available, especially if one agrees with the argument that any retaliatory or whistleblowing cause of action contains an implicit employer knowledge element of causation which is proven when the retaliatory termination itself is proven.[184]

Colorado has a whistleblower statute to protect state employees who disclose information regarding state agency actions which are not in the public interest.[185] This protection does not extend to private employees. An exception, however, exists when the employer is under contract or agreement with any agency, department or entity of the State of Colorado.[186] There are, however, a significant number of states which

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*Penetrating Doctrinal Camouflage*, *supra* note 10, at 728-30; Summers, *supra* note 15, at 11-12. *See also* 9A Lab. Rel. Rep. (BNA) 505:21-26 (May, 1987) (overview of federal whistleblowing statutes).

184. *See e.g.*, Merkel v. Scovill, Inc., 787 F.2d 174, 180 n.4 (6th Cir.), *cert. denied*, 479 U.S. 990 (1986) (if jury finds that the employee refused to sign what he believed to be a false affidavit, and the employer *knew* the information in the affidavit was false, nevertheless directing the employee to sign, and then discharges the employee for refusal to sign, such retaliation "may well be" a violation of the Age Discrimination in Employment Act), *aff'g* 573 F. Supp. 1055, 1062 (S.D. Ohio 1983) (employee asserting a wrongful discharge cause of action must prove by a preponderance of the evidence that the employer *knew* it was requesting the employee to commit perjury or falsification).

*See also* Oliver v. Department of Health and Human Servs., 34 M.S.P.R. 465 (1987), *aff'd*, 847 F.2d 842 (Fed. Cir. 1988). In *Oliver*, the Merit Systems Protection Board held that to establish a claim under 5 U.S.C. § 2302(b)(8)(A), the employee must show that: "(1) a protected disclosure was made; (2) the accused official *knew* of the claimant's disclosure; (3) the adverse action under review could, under the circumstances, have been retaliation; and (4) after careful balancing of the intensity of the accused official's motive against the gravity of the misconduct, a *nexus* is established between the adverse action and the motive." *Id.* at 470 (emphasis added) The board found the "official's knowledge" element was satisfied because the employee had repeatedly transmitted memoranda to [the employer], but the employee failed to establish the required nexus. *Id.* at 471. *Cf.* Mass v. Martin Marietta Corp., 805 F. Supp. 1530, 1541 (D. Colo. 1992) (in a Title VII case, the employee failed to prove the two elements of a retaliation claim: (1) that the employee reported the illegal conduct; and (2) that the employer retaliated; additionally, the employee's retaliation claim was not "reasonably related" to the discrimination and harassment claims contained in the underlying charge).

185. COLO. REV. STAT §§ 24-50.5-101 to -107 (1988). *See* Ward v. Industrial Comm'n, 699 P.2d 960, 967-68 (Colo. 1985) (for Freedom of Speech violations, the *Mt. Healthy* "same decision" test is applicable; *see supra* note 174). *See also* Indiv. Empl. Rights Manual (BNA) at 546:5-7 (June, 1991), *supra* note 93 (other Colorado statutes prohibiting employer retaliatory discharge).

186. COLO. REV. STAT. §§ 24-114-101 to -103 (1988 & Supp. 1992). A "private enterprise under contract with a state agency" is defined as:

> [A]ny individual, firm, limited liability company, partnership, joint venture,corporation, association, or other legal entity which is a party to any type of state agreement, regardless of what it may be called, for the procurement or disposal of supplies, services, or construction for any department, office, commission, institution, board, or other agency of state government.

*Id.* § 24-114-101(4).

An "employee is defined as any person employed by a private enterprise under contract with a state agency. *Id.* § 24-114-101(3). "Disciplinary action" includes threat of any such discipline or penalty" (coercion) *Id.* § 24-114-101(1). "Disclosure of information" is defined as written evidence to any person, or testimony before any committee of the general assembly regarding acts, omissions, policies, procedures or regulations by a private enterprise under contract with a state agency "which, if not disclosed, could result in the waste of public funds, could endanger the public health, safety or welfare, or could otherwise adversely affect the interests of the state." *Id.* § 24-114-102(2). No supervisor or appointing authority of a private enterprise under state contract "shall initiate or adminis-

have whistleblower statutes protecting private employees.[187] Michigan is the only state which includes a judicially supplied employer knowledge "element" in a whistleblower statute which is otherwise silent as to causation.[188] The employer knowledge element is, however, "simply a factor to consider in determining the principal question of causation,"[189] It is not a distinct element of a *prima facie* case, as Colorado, along with other jurisdictions have recognized.[190]

Several states require an employee to bring the alleged violation, illegality, or unsafe condition to the attention of the employer first, allowing for a reasonable opportunity to correct the situation before the employee gains the statutory protection.[191] New Hampshire allows the

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ter any disciplinary action against any employee on account of the employee's disclosure of information concerning said enterprise." *Id.* § 24-114-102(1). Exceptions are provided where the employee discloses (1) information the employee knows to be false; or (2) information which is confidential under any other provision of law. *Id.* The employee seeking protection under this statute is obliged to "make a good faith effort" to provide the information to be disclosed to the employee's supervisor, appointing authority, or member of the general assembly *prior* to disclosure of the information. *Id.* § 12-114-102(2) (emphasis added). Any aggrieved employee may bring a civil action under this statute in district court. *Id.* § 24-114-103. The prevailing employee may recover damages, costs and "such other relief as [the court] deems appropriate." *Id.*

It is arguable that had Martin Marietta been under contract in any way with the State of Colorado, and had this statute been in existence when Lorenz was discharged (COLO. REV. STAT. 24-114-101 became effective on July 1988 for acts committed on or after that date), Lorenz would have been protected under this Colorado "whistleblower" statute, and he also would have avoided the six-step public policy tort standard set out in *Lorenz*, 823 P.2d at 109. To date, there is no published Colorado case law construing COLO. REV. STAT. §§ 24-114-101 to -103.

187. CAL. LABOR CODE § 1102.5 (West 1989); CONN. GEN. STAT. ANN. § 31-51m (West 1987 & Supp. 1992); HAW. REV. STAT. §§ 378-61 to 378-69 (Supp. 1992); LA. REV. STAT. ANN. § 30:2027 (West 1989 & Supp. 1993); ME. REV. STAT. ANN. tit. 26, §§ 831-840 (West 1988); MICH. COMP. LAWS ANN. §§ 15.361-15.369 (West 1981 & Supp. 1992); MINN. STAT. ANN. § 181.932 (West Supp. 1993); N.H. REV. STAT. ANN. §§ 275-E:1 to -E:7 (Supp. 1991); N.J. STAT. ANN. §§ 34:19-1 to 34:19-8 (West 1988 & Supp. 1992); N.Y. LABOR LAW § 740 (McKinney 1988); OHIO REV. CODE ANN. §§ 4113.51-4113.53 (Anderson 1991); R.I. GEN. LAWS § 36-15-3 (1990); TENN. CODE ANN. § 50-1-304 (1991); WIS. STAT. ANN. §§ 101.595(2), 111.322(2), 111.34(2)(c) (West 1988 & Supp. 1992). For a thorough treatment and discussion of state whistleblower statutes and their pros and cons, see Adler & Daniels, *supra* note 128, at 55-68 app. A. *See generally* Martin W. Aron, *Whistleblowers, Insubordination, and Employee Rights of Free Speech*, 43 LAB. L.J. 211 (1992) (comparing New Jersey and New York statutes); John D. Feerick, *Toward a Model Whistleblowing Law*, 19 FORDHAM URB. L.J. 585 (1992) (detailed analysis of N.Y. LABOR LAW § 740 and suggestions for an improved "model").

188. Whistleblowers' Protection Act, MICH. COMP. LAWS ANN. §§ 15.361-15.369 (West 1981 & Supp. 1992). Section 15.362 of the act states:

> An employer shall not discharge, threaten, or otherwise discriminate against an employee regarding the employee's compensation, terms, conditions, location, or privileges of employment because the employee, or a person acting on behalf of the employee, reports or is about to report, verbally or in writing, a violation or a suspected violation of a law or regulation or rule promulgated pursuant to law of this state, a political subdivision of this state, or the United States to a public body, unless the employee knows that the report is false, or because an employee is requested by a public body to participate in an investigation, hearing, or inquiry held by that public body, or a court action.

189. Melchi v. Burns Int'l Sec. Servs., Inc., 597 F. Supp. 575, 582 (E.D. Mich. 1984).

190. *Lorenz*, 823 P.2d at 109; Palmer v. Brown, 752 P.2d 685 (Kan. 1988).

191. ME. REV. STAT. ANN. tit. 26, § 833(2) (West 1988); MINN. STAT. ANN. § 181.932 (West Supp. 1993); N.Y. LABOR LAW § 740 (McKinney 1988 & Supp. 1993); OHIO REV. CODE ANN. § 4113.52 (Anderson 1991).

employee to bypass advising the employer if the employee specifically believes that such reporting would not result in the employer promptly remedying the violation.[192] Likewise, New Jersey allows the employee to forgo disclosure to the employer in an emergency, when the employee is reasonably certain that the policy or practice is *known* by one or more supervisors, or when the employee fears physical harm as a result of the disclosure.[193] In cases where the employee is required to first advise the employer to gain later statutory protection, and the employee does so, the employer knowledge element at common law is patently satisfied.[194] Thus, a few state whistleblowing statutes provide guidance towards a conclusion that requiring proof of employer knowledge, as in *Lorenz*, is redundant; proving the causation element just by the employer's retaliatory act will suffice.

Only Montana, Puerto Rico, and the Virgin Islands have a comprehensive wrongful discharge statute preempting common law actions.[195] Montana currently has the most comprehensive legislation in the area of retaliatory discharge, including retaliation for the employee's refusal to violate public policy.[196] Lack of good cause and violation of the employer's own express provisions in its written personnel policies are covered as well.[197] There is no need for a specific chain of causation to be proven, as all common law remedies are preempted.[198] Discharges for retaliation for refusing to violate public policy, whistleblowing, and contractual breaches are statutorily covered by a one year statute of limitations, and mutually agreed dispute resolution through arbitration is provided for procedurally.[199] The Virgin Islands Code sets out detailed definitions of what is "just cause" for discharges; anything else is deemed to be a wrongful discharge.[200] Likewise, Puerto Rico legislation contains a list of examples of "good cause." Wrongfully or constructively discharged employees may recover one month's salary plus one week's salary for each year of service.[201]

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192. N.H. REV. STAT. ANN. § 275-E:2 (Supp. 1991).

193. N.J. STAT. ANN. § 34:19-4 (West 1988 & Supp. 1992).

194. Providing the employee, in good faith, advises the employer as to her reasonable belief that the employer's directed act was unlawful or against common public policy, the employer may be said to "have notice" or "knowledge" of the employee's point of view. Ignorance or an adverse employment decision by the employer after this notice may be described as deliberate, intentional, or at the least, done with obvious knowledge of the employee's perception of the disputed circumstances. *See* N.J. STAT. ANN. § 34:19-4 (West 1988 and Supp. 1992); *supra* note 190-92 and accompanying text.

195. 82 AM. JUR. 2D *Wrongful Discharge* § 10, at 680 n.90 (1992).

196. MONT. CODE ANN. §§ 39-2-901 to -914 (1991).

197. *Id.* § 39-2-904.

198. *Id.* § 39-2-913.

199. *Id.* §§ 39-2-904, 39-2-911, 39-2-914. Proof of fraud or actual malice is necessary to recover punitive damages. Emotional distress and pain and suffering recoveries are eliminated. *Id.* § 39-2-905. For a detailed historical analysis of case law construing Montana's Wrongful Discharge From Employment Act, see Leonard Bierman & Stuart A. Youngblood, *Interpreting Montana's Pathbreaking Wrongful Discharge From Employment Act: A Preliminary Analysis*, 53 MONT. L. REV 53 (1992).

200. V.I. CODE ANN. tit. 24, §§ 77-79 (Supp. 1987).

201. BRODIE, *supra* note 183, at 231-32 (describing P.R. LAWS ANN. tit. 29, § 185(a)-(e)).

While the Montana, Puerto Rico, and Virgin Islands statutes do not provide insight into causation analysis, due to their preemption of common law wrongful discharge claims, they do offer valuable models of how future statutory employment law may typically operate. With common law claims eliminated, as well as "add-on" claims of emotional distress, interference with contract, etc., the penalty for firing employees in retaliation for their unwanted *lawful* behavior may become nothing more than a minor inconvenience or a "slap-on-the-hand" fine accompanied with a relatively low dollar figure in back pay. $500,000 jury verdicts will become as ancient a concept as a 50 cent gallon of gas. In effect, this type of legislation represents an at-will situation, because the employer no longer has a serious deterrent to prevent retaliatory terminations. It may also indicate a renewed sense that the average worker is no more important than a chessboard pawn being sacrificed for the good of the big-business economic machine.[202]

## V. CONCLUSION

Colorado's pronounced adoption of the public policy exception to the at-will employment doctrine represents a major step forward in protecting the rights and interests of the public by protecting employees who have been terminated out of spite or lawfully protected activity, yet leaves a potential "loophole" in the requirements for evidentiary proof

202. The Model Uniform Employment-Termination Act, *reported in* 9A Lab. Rel. Rep. (BNA) 540:21 (Dec. 1991), is also highly controversial. The final version was approved on August 8, 1991, but a motion to draft the Act as a uniform law, which would have a uniform measure introduced in each state legislature was defeated. *Id. See also* Callahan, *supra* note 20, at 516-17 (noting that the Model Law was met with much dissatisfaction from both the plaintiff and defense groups represented). The Act, which in many ways is similar to Montana's Wrongful Discharge From Employment Act, *see supra* notes 196-99 and accompanying text, calls for either severance pay upon termination, or "good cause" to dismiss an at-will employee who has been employed by the same employer at least one year. 9A Lab. Rel. Rep. (BNA) at § 3, 540:32-33. *See also id.* § 10, 540:42 (prohibiting retaliatory discharges in connection with protected activity under the Act).

Adoption by state legislators of the Model Uniform Employment Termination Act in the near future is unlikely. *See* Randall Samborn, *At-Will Doctrine Under Fire; Model Act Divided Employment Bar,* NAT'L L.J., Oct. 14, 1991, at 1. Proponents claim the Act will level the playing field by providing a balance between the extreme of arbitrary dismissal and costly litigation, thus allowing for a cheap and fast remedy for being fired without just cause, and also allowing employers to exercise business judgment in good faith in adjusting their workforce. Other advantages include financial predictability for employers with a potential for future insurance coverage for claims like that currently found with Workers' Compensation statutes. Opponents complain that mandatory arbitration, damage caps and preemption of common law tort and contract actions will take much of the motivation away from plaintiff's attorneys. Further, an easily insurable risk may be viewed apathetically by the employer, and the judicial systems within a state may become flooded with claims. *See generally* Kempf & Taylor, *supra* note 15 (proposing their own version of a Model Termination Act, similar in many respects to Montana's); Glenn D. Newman, *The Model Employment Termination Act in the United States: Lessons from the British Experience with Uniform Protections Against Unfair Dismissal,* 27 STAN. J. INT'L L. 393 (1990) (commentary and criticism of the Model Uniform Employment Termination Act, and an insightful comparison with the U.K.'s Employee Protection (Consolidation) Act of 1978); 82 AM. JUR. 2D *Wrongful Discharge* § 10, at 680-81 (1992).

of the employer's bad conduct.[203] The lack of precise language in *Lorenz* may be an indication that the Colorado Supreme Court wishes to retain an equally balanced test for determining whether a *prima facie* case has been met by the employee, allowing for case by case interpretations which are particularly fact driven.[204]

An at-will employee in Colorado supposedly now has protection from being terminated for refusing to violate specific laws for an employer, or for being denied the rights and privileges that come with citizenship or the job itself. The complication in this "pro-plaintiff" decision, is that the employee is now theoretically farther away from establishing a *prima facie* case then was the employee previous to this decision. While the standard expressed in *Lorenz*[205] is carefully worded so as to potentially include yet untried fact patterns, the *Cronk I* standard[206] was a "cleaner," more well-defined standard that carried a certain degree of predictability in the law.

On the other hand, it seems more likely that the employer knowledge element will be easily proven when the motive for the employee's discharge is proven to be retaliatory. This is due to the theory that once the retaliatory act itself is proven, the employer knowledge element has been implicitly proven as well. If Colorado appellate courts accept the argument that distinctions in wrongful discharge, public policy and whistleblower terminology are unnecessary because they are all forms of retaliatory discharge, the inevitable result would be agreement with the proposition that the employer knowledge element is implicitly proven, notwithstanding other evidence presented, *whenever* a retaliatory discharge itself is proven by a preponderance of the evidence. Thus, the employer knowledge element is unnecessary in proving causation in a retaliatory discharge because when a retaliatory discharge occurs, and the reason for the employer's retaliation can be traced and proven, then the employer either *should* have known, or *must* have known of the employee's act or refusal to act which prompted the employer's retaliation.

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203. Namely, the uncertainty of how the *Lorenz* employer knowledge element must be satisfied.

204. COLO. CIVIL JURY INSTRUCTIONS 3d §§ 31:9 & 31:10 (Cum. Supp. 1993) follow the *Lorenz* decision requiring the jury to find by a preponderance of the evidence, *all* of the elements set out in *Lorenz* including that the "defendant was aware or reasonably should have been aware, that plaintiff's refusal to comply with the defendant's directive was based on plaintiff's reasonable belief that to do so would have been (illegal) (contrary to plaintiff's duty as a citizen) (a violation of plaintiff's legal right or privilege as a worker)." *Id.* § 39:9. The Notes on Use for §§ 31:9 & 31:10 indicate, however, that "it is not clear whether the requirements set forth in *Lorenz* were intended to apply to a situation in which an employer discharges an employee for exercising a specific statutory right or duty without any prior order or directive not to do so." *Id.* at 264.

The author wishes to thank the Hon. Charles Pierce, Colorado Court of Appeals, and his staff, for the opportunity to inspect and copy these jury instructions and accompanying notes in the "working-manuscript" form. Judge Pierce is on the Colorado Supreme Court Committee on Pattern Jury Instructions — Civil. Thanks are also extended to Robert Truhlar, Esq., of Truhlar & Truhlar, Denver, Colorado, for advice regarding the existence of these recently proposed and adopted jury instructions.

205. *Lorenz*, 823 P.2d. at 109.

206. *See supra* note 5 and accompanying text.

In such a situation, the employer's knowledge, whether actual or constructive, *must* be present or the discharge would not be retaliatory in nature. Once the first five *prima facie* elements in *Lorenz* are satisfied, then the sixth element of required employer knowledge is also proven by implication. Should the courts in Colorado, however, continue to maintain that the employer knowledge element is both required and important, then the courts should construe this element liberally on motions for summary judgment, and allow the jury to make this combined factual and legal decision.

Another potential solution lies in the chambers of the Colorado Legislature. Other states and territories have enacted legislation to protect non-unionized employees from wrongful discharge by describing the definition of what is either "good cause" or "bad cause," and providing remedies for discharges without good cause, as well as remedies for whistleblowing.[207] Since the *Lorenz* court has not provided a *predictable* standard or solution to the public-policy exception to the at-will employment doctrine, it would be in the best interests of public policy and the tax-paying voters of Colorado, for the legislature to thoroughly address this issue, but not necessarily by following the examples of Montana or the Model Employment Termination Act. Legislation may provide a workable long-term answer. Careful consideration, however, will be necessary to draft a statute with the deterrence factor equal to that of an unpredictable jury verdict.

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207. *See supra* notes 183-202 and accompanying text.

# ADMINISTRATIVE LAW SURVEY

The majority of federal agency decisions reviewed by the Tenth Circuit during the survey period exhibited significant deference to agency decision-making. Although judicial review of agency decision-making was pervasive, deference to agency decisions permeated all areas of administrative action. Part I of this Article examines the Tenth Circuit's adherence to the Supreme Court's *Chevron* doctrine of deference to an agency's interpretation of its own statute. Part II discusses the distinction between substantive and interpretive rulemaking. Part III discusses the ability of administrative agencies to create rules through adjudicative hearings, rather than informal rulemaking procedures under the Administrative Procedure Act.

## I. DEFERENCE TO AGENCY INTERPRETATIONS: *WYOMING V. ALEXANDER*

### A. *Background*

The Administrative Procedure Act (APA),[1] numerous organic statutes and the Supreme Court's non-delegation doctrine provide the basis for judicial review of administrative decisions.[2] In devising the appropriate standard of review the APA does not address the level of deference accorded agency interpretation. Prior to 1984, the courts did not take a consistent approach toward the issue of deference.[3] Even the Supreme Court seemed incapable of developing a consistent position. Although one line of cases demonstrated deference to agency decisions,[4] in a separate and equally distinct line of cases the Court construed statutes and gave little or no deference to administrative agency decisions.[5]

Much of the uncertainty ended in 1984 with the Court's decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*[6] Without explicitly overruling or disapproving of a single case, the Court defined the level of deference the judiciary should grant administrative agencies practicing rulemaking functions. In *Chevron*, the Environmental Protection Agency (EPA) defined the term "stationary source" in the Clean Air

1. 5 U.S.C. §§ 701 - 706 (1988).

2. Kenneth W. Starr, *Judicial Review in the Post-Chevron Era*, 3 YALE J. ON REG. 283, 307-08 (1986).

3. *See, e.g.*, Thomas W. Merrill, *Judicial Deference to Executive Precedent*, 101 YALE L.J. 969, 971 (1992); Claude T. Coffman, *Judicial Review of Administrative Interpretations of Statutes*, 6 W. NEW ENG. L. REV. 1, 3 (1983).

4. *See* Aluminum Co. of Am. v. Central Lincoln Peoples' Util. Dist., 467 U.S. 380, 389 (1984); Blum v. Bacon, 457 U.S. 132, 141 (1982); Udall v. Tallman, 380 U.S. 1, 4 (1965); NLRB v. Hearst Publications, Inc., 322 U.S. 111 (1944).

5. *See* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141 (1982); Jewett v. Commissioner, 455 U.S. 305 (1982); United States v. Swank, 451 U.S. 571 (1981); Morton v. Ruiz, 415 U.S. 199 (1974).

6. 467 U.S. 837 (1984).

Act[7] to permit operators of polluting facilities to treat all polluting devices as if they were in a single "bubble."[8] The Natural Resources Defense Council (NRDC) and several other groups challenged the "bubble" definition as contrary to earlier rulings of the EPA.[9] In invalidating the rule, the United States Court of Appeals for the District of Columbia reasoned that the Clean Air Act did "not explicitly define what Congress envisioned as a 'stationary source' "[10] and that the legislative history was "at best contradictory."[11] The court then substituted its own interpretation of the statute for that of the agency.[12]

On review, the Supreme Court reversed and set forth a two-step framework for analyzing an agency's interpretation of a statute. First, courts must determine whether "Congress has directly spoken to the precise question at issue."[13] If Congress addressed the precise question in an unambiguous fashion, the agency and the court have no choice but to give full effect to the plain meaning of the statute.[14] Should the intent of Congress be ambiguous, however, a court may only determine "whether the agency's answer is based on a permissible construction of the statute."[15] In devising the test, the Court relied on congressional intent. An ambiguous statute, the Court reasoned, should be considered as an implicit legislative delegation to the administrative agency giving it the discretion to decide which of several permissible interpretations of the statute to adopt.[16] Under *Chevron* there is no longer a single, correct meaning on every point in a statute, and agencies are the preferred gap fillers.[17]

Although the decision appeared to succinctly resolve much of the confusion over agency deference, the Supreme Court's failure to consistently utilize *Chevron*'s two-step framework raised questions about its precedential value.[18] Likewise, an analysis of appellate court decisions

7. 42 U.S.C. § 7502(b)(6) (1988).

8. *Chevron*, 467 U.S. at 840. This lenient definition of "stationary source" exempted replacements of individual pieces of equipment from the EPA's standards so long as the total emissions level of the facility did not increase above a certain level. *Id.*

9. *Id.* at 841.

10. Natural Resources Defense Council, Inc. v. Gorsuch, 685 F.2d 718, 723 (D.C. Cir. 1982).

11. *Id.* at 726 n.39.

12. Relying on the "purposes of the non-attainment program" and two earlier decisions, ASARCO, Inc. v. EPA, 578 F.2d 319 (D.C. Cir. 1978) and Alabama Power Co. v. Costle, 636 F.2d 323 (D.C. Cir. 1979), the court of appeals found the bubble definition inconsistent with the statute's purpose of ameliorating, rather than merely maintaining, air quality. *NRDC*, 685 F.2d at 726-27.

13. *Chevron*, 467 U.S. at 842.

14. *Id.* at 842-43.

15. *Id.* at 843.

16. *Id.* at 844.

17. With this newly devised two-step analysis, the Court concluded that the D.C. Circuit should not have addressed whether the "bubble" definition was inappropriate or inconsistent with the policies underlying the statute. *Id.* at 845. Instead, the inquiry should have been "whether the Administrator's view that it is appropriate in the context of this particular program is a reasonable one." *Id.*

18. *See* INS v. Cardoza-Fonseca, 480 U.S. 421, 445-448 (1987) (limiting *Chevron* to those situations where an agency must apply a legal standard to particular facts); Merrill, *supra* note 3, at 981 (suggesting the Supreme Court has applied the *Chevron* framework to

reveals a similar lack of consistency in following the *Chevron* framework.[19] In its most recent term, the Tenth Circuit reviewed two administrative agency decisions and specifically addressed the question of deference.[20] In both cases, the court applied the *Chevron* analysis in reaching its decision.

B. *Agency Action*

In *Wyoming v. Alexander*[21] the state sought review of the final decision of the United States Department of Education (DOE) requiring Wyoming to refund federal vocational education funds received under the Vocational Education Act Amendment (VEA).[22] The state obtained the funds pursuant to a federal "grant-in-aid" for vocational education administered by the DOE under the VEA,[23] which allowed states to draw from predetermined grants for local schools on an as-needed basis.[24] A key condition of the VEA, and the subject of the suit, was the requirement that Wyoming, as the receiving state, set-aside ten percent of the total funds it utilized for handicapped students and twenty percent for disadvantaged and non-English speaking students.[25]

The DOE audited Wyoming's use of funds allocated under the VEA in 1984 and found violations of the set-aside requirements.[26] Based upon this report, the Assistant Secretary for Vocational and Adult Education required the state to return $201,922.[27] Although the state admitted to the misapplication of $16,363, it sought review of the Assistant Secretary's ruling before the agency's Education Appeal Board (EAB).[28]

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only half of the cases presenting questions of deference); Linda R. Hirshman, *Postmodern Jurisprudence And The Problem of Administrative Discretion*, 82 NW. U. L. REV. 646, 688-703 (1988) (discussing the failure of *Chevron* to effectuate significant changes in the relationship between courts and agencies).

19. *See* Continental Training Servs., Inc. v. Cavazos, 893 F.2d 877, 885-86 (7th Cir. 1990) (reiterating the *Cardoza-Fonseca* view that *Chevron* does not apply to every case involving agency deference); Union of Concerned Scientists v. NRC, 824 F.2d 108, 113 (D.C. Cir. 1987) (statutory construction issues dictate courts use "traditional tools of statutory construction to ascertain congressional intent"); UAW v. Brock, 816 F.2d 761, 765 (D.C. Cir. 1987) (courts need not defer to agency opinions on ambiguous statutory provisions if the issues involve "a pure question of statutory construction"); Peter H. Schuck & E. Donald Elliott, *To The Chevron Station: An Empirical Study of Federal Administrative Law*, 1990 DUKE L.J. 984, 1040-41, 1059 (providing an analysis of decisions which have followed or diverged from the *Chevron* framework); *see also* Hon. Patricia M. Wald et al., *The Contribution of the D.C. Circuit to Administrative Law*, 40 ADMIN. L. REV. 507, 530 (1988) (discussing the D.C. Circuit's increased use of *Cardoza-Fonseca*).

20. In addition to Wyoming v. Alexander, 971 F.2d 531 (10th Cir. 1992), discussed immediately below, the Tenth Circuit also addressed deference towards an agency in Furr's/Bishop's Cafeterias, L.P. v. INS, 976 F.2d 1366 (10th Cir. 1992).

21. 971 F.2d 531 (10th Cir. 1992).

22. 20 U.S.C. §§ 2301 - 2471 (1988 & Supp. III 1992).

23. *Alexander*, 971 F.2d at 533.

24. *Id.* at 534. Pursuant to the VEA, Wyoming was allotted $1,110,314 in 1979 and $1,062,848 in 1980. Of these funds, Wyoming withdrew all but $61,304 in 1979 and withdrew all allotted funds in 1980. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.* at 534-35.

The EAB reviewed the Secretary's decision and, while finding some rulings untenable, held DOE was entitled to a refund of $87,859 for misapplication of funds.[29] The Secretary of Education refused to alter this decision and the state petitioned for review by the Tenth Circuit.[30]

C. *The Tenth Circuit Opinion*

Wyoming did not dispute the facts, but did contest the calculation of the refund. The state contended that the proper interpretation of the set-aside requirement called for thirty percent of every dollar utilized to be applied to the targeted student groups.[31] Wyoming also argued that thirty percent of any remaining, unspent funds at the end of the year should be offset or "credited" against any shortages in the required application to the targeted groups.[32]

In contrast, the EAB interpreted the set-aside restriction to require states to spend allocated funds only on targeted students until the minimum per centum of the total grant was reached.[33] Only then could Wyoming spend the remaining funds on other approved, untargeted student groups.[34]

These two conflicting, although rational, interpretations of the set-aside restriction resulted from the absence of express congressional language on the question.[35] In resolving the dispute, the Tenth Circuit found no previous judicial interpretation of the statute.[36] The court found that, while sparse, the legislative history supported EAB's decision.[37] The court specifically relied on: (1) the title to the VEA section that read "National *Priority* Programs";[38] (2) a Senate Committee statement that "[t]hese particular set-asides were established to provide *a base amount each State must use for programs for students with special needs* . . .";[39] and (3) a Senate Committee statement that, "given the limited amount of federal assistance available, *it is the Committee's intent that scarce dollars will be first devoted to those with greatest needs*."[40] Recognizing the inconclusiveness of the statements, the court noted that "the rationale supporting the EAB's initial decision is not as well developed as it might

29. *Id.* at 535.
30. *Id.*
31. *Id.* at 536-37 n.7.
32. *Id.*
33. *Id.* at 537.
34. *Id.* Technically, the order in which these funds were spent did not matter, but the EAB's rationale directly affected the computation of the refund. In theory, the EAB's interpretation held that if the total grant equaled $100 and at least $30 was spent on targeted groups, how much more of the remaining $70 the state spent on any approved program was not relevant. However, if the state spent only $80 in total, allocating thirty percent, or $24 to targeted students, it had misapplied $6 and would be penalized accordingly. The EAB's interpretation accounted for fines totaling $25,633 more than the interpretation Wyoming asked the court to accept. *Id.*
35. *See e.g.*, S. REP. NO. 882, 94th Cong., 2d Sess. 54 (1976).
36. *Alexander*, 971 F.2d at 537 n.9.
37. *Id.*
38. *Id.* (emphasis in original case) (referencing 20 U.S.C. § 2310 (1988)).
39. *Id.* (emphasis in original case) (referencing S. REP. No. 882, *supra* note 40, at 57).
40. *Id.* (emphasis in original case).

have been."[41]

Aside from the legislative history, the court acknowledged that *Chevron* dictated a "narrow and deferential" standard of review.[42] Although it upheld EAB's interpretation, the court expressed uncertainty as to whether the interpretation was a permissible construction of the VEA statute. The court acknowledged that, absent an unreasonable agency interpretation of a statute, its own view of the proper equitable outcome was irrelevant.[43] The court thus concluded "that the EAB acted within the intent of Congress by holding Wyoming liable for its failure to fulfill its promise to expend on the designated programs the full set-aside amounts."[44]

D. *Analysis*

The various circuit courts inconsistently apply the *Chevron* doctrine.[45] Despite the court's uncertainty with the EAB's actions, the application of the doctrine in *Alexander* illustrates the prevalence of *Chevron* in the Tenth Circuit.

The court alluded that its own view of the best interpretation of the statutory language was not the same as that adopted by the EAB.[46] The court's statements that "[t]he EAB has made a reasonable interpretation of the VEA, to which we *must* defer"[47] and that "[t]he EAB interpretation reasonably and permissibly comports with the *apparent* intent of Congress"[48] may be a veiled indication that, in the court's eyes, the EAB did not make the most correct reasonable interpretation. A court following the *Chevron* doctrine could just as easily have found the EAB's interpretation an unreasonable construction of the statute. For example, the court could have held the state unambiguously requires the interpretation advanced by Wyoming and that, therefore, EAB's interpretation was unreasonable. Such a finding would have justified reversing EAB's decision.

The rationale for a finding of an unreasonable construction of the statute is supported by subsequent congressional action. Prior to 1985, Congress did not specifically outline the process for calculating set-aside refunds.[49] In 1988, however, Congress amended the statute prospectively to address the specific issue presented in *Alexander*. The amendment, as codified, holds that states misappropriating funds "shall be required to return funds in an amount that is proportionate to the extent of the harm its violation caused to an identifiable Federal interest associated with the program under which the recipient received the

41. *Id.* at 537.
42. *Id.* at 536.
43. *Id.* (citing Bennett v. New Jersey, 470 U.S. 632, 646 (1985)).
44. *Id.* at 536-37.
45. *See supra* note 19 and accompanying text.
46. *See supra* text accompanying notes 35-43.
47. *Alexander*, 971 F.2d at 539 (emphasis added).
48. *Id.* at 537 (emphasis added).
49. *Id.* n.8.

award."[50] Wyoming's 1984 violation date precluded application of the 1988 amendment to this case. The purpose of the amendment was presumptively to rectify EAB interpretations that were inconsistent with congressional intent or simply viewed by legislators as unfair or irrational. Regardless of remedial congressional acts regarding the EAB, *Alexander* illustrates the pervasiveness of the *Chevron* doctrine in the Tenth Circuit.

## II. SUBSTANTIVE V. INTERPRETIVE RULEMAKING: *ROCKY MOUNTAIN HELICOPTERS, INC. V. FAA*

### A. *Background*

In *Rocky Mountain Helicopters, Inc. v. FAA*,[51] the Tenth Circuit had no difficulty deciding whether a rule promulgated by an agency was substantive or interpretive. The court's ease in making this decision, however, should not downplay the confusion that often surrounds this question and the important ramifications of interpretive rules on affected parties.

In the Administrative Procedure Act, Congress recognized a difference between substantive and interpretive rules.[52] Substantive rules are those that create or change rights, duties or obligations.[53] Interpretive rules, in contrast, simply explain and clarify existing laws. They represent an agency's statement of its construction of the rule.[54] Although substantive rules, prior to adoption, require notice and comment procedures defined by the APA,[55] interpretive rules do not.[56] The notice and comment requirement allows interested parties to express their views to the agency and to influence the decision-making process. This requirement adds the "elements of openness, accountability, and legitimacy" to the rulemaking process.[57]

An interpretive rule requires only that the agency publish its decision in the *Federal Register* after adoption.[58] An interested party has no right to participate in the decision-making process. The difference in procedural approach between substantive and interpretive rules arises out of practical necessity. Congressional delegation of the administra-

50. 20 U.S.C. § 1234b(a)(1) (1988).

51. *Id.*

52. 5 U.S.C. § 553 (1988). *See also* 2 KENNETH C. DAVIS, ADMINISTRATIVE LAW TREATISE §§ 7.8-.13 (2d ed. 1978).

53. 5 U.S.C. § 553 (1988); Michael Asimow, *Nonlegislative Rulemaking And Regulatory Reform*, 1985 DUKE L.J. 381, 383; Peter J. Henning, *An Analysis Of The General Statement Of Policy Exception To Notice and Comment Procedures*, 73 GEO. L.J. 1007, 1009 (1985).

54. Asimow, *supra* note 53, at 383; Kevin W. Saunders, *Interpretive Rules With Legislative Effect; An Analysis And A Proposal For Public Participation*, 1986 DUKE L.J. 346, 346.

55. 5 U.S.C. § 553(b) - (c) (1988).

56. The APA specifically exempts "interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice." 5 U.S.C. § 553(b)(3)(A) (1988).

57. Asimow, *supra* note 53, at 402; *see* Henning, *supra* note 53, at 1012.

58. 5 U.S.C. § 552(a)(1)(D) (1988).

tion of statutes to agencies implicitly requires gap-filling measures.[59] In theory, this interpretive power does not create difficulties for interested parties because agency findings merely clarify existing law and unfavorable interpretations can be challenged in court.[60] Under *Chevron*,[61] both types of rules receive equal deference[62] and, as a result, they often have the same practical impact.[63] Although not legally binding on parties, an interpretive rule generally represents the agency's final position, invoking deference by the courts.[64] The importance of the distinction between substantive and interpretive rules arose last year in the Tenth Circuit.

B. *Agency Action*

Rocky Mountain Helicopters operates an emergency medical evacuation service on call both day and night.[65] In 1989, Rocky Mountain notified the FAA of its intent to use night vision enhancement devices (night vision goggles) in its operations.[66] Night vision goggles are used primarily in military operations.[67] The local Flight Standards District Office (FSDO) of the FAA prohibited use of the goggles and notified Rocky Mountain that its operations specifications would be amended accordingly.[68] Upon Rocky Mountain's protest, the FSDO reaffirmed its position after consulting both regional and national FAA personnel.[69] Rocky Mountain submitted written arguments about the amendment but contended that the FAA impaired its ability to respond by failing to be specific about the grounds for the decision.[70] Rejecting the arguments, the FSDO amended Rocky Mountain's operating specifications as proposed.[71]

In response, Rocky Mountain filed for reconsideration with the

59. *See* Morton v. Ruiz, 415 U.S. 199, 231 (1974); *see also* Asimow, *supra* note 53, at 385; Saunders, *supra* note 54, at 350.

60. *See* Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944); Saunders, *supra* note 54, at 346 n.5.

61. Chevron U.S.A. Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984) (*see supra* text accompanying notes 16-21 for reiteration of the *Chevron* test); Saunders, *supra* note 54, at 356.

62. Asimow, *supra* note 53, at 389. The author states "[b]ecause both legislative and interpretive rules frequently explain the meaning of language, there is no obvious way to determine whether an agency with legislative rulemaking power has made 'new law' or interpreted 'existing law.'" *Id.* at 394 (citation omitted). *See also* Note, *A Functional Approach to the Applicability of Section 553 of the Administrative Procedure Act to Agency Statements of Policy*, 43 U. CHI. L. REV. 430, 434-35 n.24 (1976); General Motors Corp. v. Ruckelshaus, 742 F.2d 1561, 1565 (D.C. Cir. 1984) (the distinction between interpretive and substantive rules is "enshrouded in considerable smog"), *cert. denied*, 471 U.S. 1074 (1985).

63. Asimow, *supra* note 53, at 384.

64. *Id.* at 385. *See also supra* the text accompanying notes 7-20 discussing *Chevron* test of deference to agency decisions.

65. *Rocky Mountain Helicopters*, 971 F.2d at 546.

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

FAA's Director of Flight Standards Service,[72] asserting that the FAA had violated the notice and comment requirement of the APA because the amendment constituted substantive rulemaking.[73] Citing safety concerns regarding night vision goggles, the Director denied Rocky Mountain's request for reconsideration.[74] Rocky Mountain appealed the decision.

### C. *The Tenth Circuit Opinion*

The Tenth Circuit had to decide whether the FAA's rulemaking procedure regarding Rocky Mountain Helicopters was substantive or, as the FAA argued, interpretative and a "reasonable interpretation of . . . existing statutes."[75] Specifically, FAA argued that since the APA does not require notice and comment procedures when an agency promulgates interpretive rules, it was under no duty to allow Rocky Mountain the opportunity to contribute to the decision-making process.[76] Rocky Mountain argued that it was entitled to the benefit of notice and comment procedures because the FAA has substantive rulemaking authority.[77]

The Tenth Circuit utilized definitions of substantive versus interpretive rulemaking drawn from its earlier holding in *Knutzen v. Eben Ezer Lutheran Housing Center*.[78] The court began its analysis by defining a substantive rule as one "promulgated pursuant to a direct delegation of legislative power by Congress [that] changes existing law, policy, or practice."[79] An interpretive rule is one which either is "made by an agency having no authority to issue a substantive rule"[80] or, if issued by an agency with the requisite authority to issue a substantive rule, "attempts to clarify an existing rule but does not change existing law, policy, or practice."[81] The court noted, however, the existence of other approaches: "whether [the] rule affects individual rights and obligations,"[82] "whether [the] rule depends on a statute for substantive meaning or is in itself substantive,"[83] "whether [the] rule will create new law,

72. *Id.* FAA agency decisions may be appealed to the agency director. 14 C.F.R. § 135.17(d) (1992).

73. *Rocky Mountain Helicopters*, 971 F.2d at 546; *see supra* text accompanying notes 52-57.

74. *Rocky Mountain Helicopters*, 971 F.2d at 546. The FAA based its decision on 14 C.F.R. § 91.13(a) (1989) prohibiting the careless or reckless operation of an aircraft, and 14 C.F.R. § 135.17(d) (1989) allowing the amendment of a licensee's operations specifications for safety reasons. *Rocky Mountain Helicopters*, 971 F.2d at 546.

75. *Id.*

76. *Id.*

77. *Id.*

78. 815 F.2d 1343 (10th Cir. 1987).

79. *Rocky Mountain Helicopters*, 971 F.2d at 546 (citing Knutzen v. Eben Ezer Lutheran Hous. Ctr., 815 F.2d 1343, 1351 (10th Cir. 1987)).

80. *Id.* at 547.

81. *Id.* at 546-47.

82. *Id.* at 547 n.2 (citing Morton v. Ruiz, 415 U.S. 199, 232 (1974)).

83. *Id.* (citing Rochna v. NTSB 929 F.2d 13, 15 (1st Cir. 1991)).

rights, or duties,"[84] "whether [the] rule [is] issued in [the] form of an explanation,"[85] and "whether [the] rule has substantial impact on those it affects."[86]

The court acknowledged the viability of Rocky Mountain's claim by noting that the FAA's substantive rulemaking authority was "undisputed."[87] Given the FAA's powers, the court reasoned that the "determinative question here is whether prohibiting the use of night vision goggles constitutes a change in existing law, policy, or practice."[88]

Rocky Mountain asserted that the FAA's determination changed existing law, policy, or practice since the FAA had not previously prohibited the use of night vision goggles in civil aviation.[89] Rocky Mountain relied on the fact that, although night vision goggles were not previously used in civil aviation, the FAA had not specifically prohibited them.[90] Spending little time analyzing Rocky Mountain's rationale, however, the court simply stated that "[n]ight vision goggles . . . have never been allowed in civil aviation."[91] Surprisingly, this brief conclusive statement comprised the court's entire rationale. The court thus held that the FAA's actions did not change existing law, policy, or practice.[92]

### D. *Analysis*

Although it had little difficulty reaching a decision, the court acknowledged that the confusion afflicted not only agencies and parties affected by agency rulemaking, but also the courts. The court recognized numerous variant styles of judicial determination of the substantive-versus-interpretive question and noted that "[t]his lack of a uniform approach may attest to the difficulty of the determination."[93]

The court's recognition of the confusion surrounding the determination of a rule's substantive or interpretive nature reflects the view that "the distinction between the two types of rules is 'enshrouded in considerable smog.' "[94] Moreover, the APA provides no explicit solution.[95] That substantive and interpretative rules often have the same practical effect on the public compounds the problem.[96] The original justifica-

84. *Id.* (citing General Motors Corp. v. Ruckelshaus, 742 F.2d 1561, 1565 (D.C. Cir. 1984), *cert. denied* 471 U.S. 1074 (1985)).

85. *Id.* (citing Batterton v. Marshall, 648 F.2d 694, 705 (D.C. Cir. 1980)).

86. *Id.* (citing 2 KENNETH C. DAVIS, ADMINISTRATIVE LAW TREATISE § 7.16 (2d ed. 1979)).

87. *Id.* at 547. *See* 49 U.S.C. §§ 1348, 1421 (1988 & Supp. III 1992).

88. *Rocky Mountain Helicopters*, 971 F.2d at 547.

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.* The Tenth Circuit vacated the FAA's decision and remanded the case back to FAA, however, for its failure to demonstrate that the factual findings underlying its interpretation were supported by substantial evidence. *Id.* at 547-48.

93. *Id.* at 547 n.2; *see supra* text accompanying notes 85-89.

94. La Casa Del Convaleciente v. Sullivan, 965 F.2d 1175, 1177 (1st Cir. 1992) (quoting General Motors Corp. v. Ruckelshaus, 742 F.2d 1561, 1565 (D.C. Cir. 1984), *cert. denied* 471 U.S. 1074 (1985)).

95. Henning, *supra* note 53, at 1008.

96. Asimow, *supra* note 53, at 384.

tion for allowing interpretive rulemaking—that it does not affect one's rights, duties or obligations—is often a moot point. Since courts are inclined to give deference to agency decisions, a challenge of an interpretive rule, such as Rocky Mountain's, is likely to be fruitless.

The Tenth Circuit's deference to agency proclamations of a rule as substantive or interpretive is unlikely to change in the future. The imposition of notice and comment requirements on all rulemaking would discourage agencies from making any interpretive rules. The argument that the additional workload and costs and decreased efficiency would encourage agencies to proceed only in an ad hoc manner is well reasoned.[97] Although some interested parties will be detrimentally excluded from participation in agency decision-making, the overall efficiency of interpretive rules and the expected undesirable agency reaction to mandatory notice and comment requirements argues for the continuance of interpretive rulemaking. The Tenth Circuit's brief analysis in *Rocky Mountain* illustrates courts' continuing acceptance of interpretive rules.

## III. RULEMAKING THROUGH ADJUDICATION: *NUNEZ-PENA V. INS*

### A. *Background*

An administrative agency's ability to make rules flows from a congressional delegation of legislative power.[98] In the landmark 1947 ruling *SEC v. Chenery Corp.*,[99] the Supreme Court held that a federal administrative agency may announce new rules of law in an adjudicatory hearing and apply those rules to the parties before it.[100] *Chenery* became the first Supreme Court case to expressly validate the development of rules in what resembled a common law approach.

Under the APA agencies make rules through either quasi-legislative or adjudicatory procedures.[101] The APA, however, does not provide detailed guidelines for the specific use of either set of procedures.[102] In *Chenery*, the Supreme Court held that the choice of utilizing rulemaking or adjudicative procedures "lies primarily in the informed discretion of the administrative agency."[103]

Adjudicatory and quasi-legislative rules differ significantly. Quasi-legislative rulemaking promulgates rules of "general or particular applicability and future effect"[104] and requires an agency to follow notice and

97. *See* Pacific Gas & Elec. Co. v. Federal Power Comm'n, 506 F.2d 33, 48 (D.C. Cir. 1974) (agencies often have the choice of proceeding in an ad hoc manner or by issuing policy statements); Asimow, *supra* note 53, at 386; Henning, *supra* note 53, at 1013; Saunders, *supra* note 54, at 369.

98. Ron Beal, *Ad Hoc Rulemaking In Texas: The Scope Of Judicial Review*, 42 BAYLOR L. REV. 459, 463 (1990).

99. 332 U.S. 194 (1947).

100. *Id.* at 202-04.

101. 5 U.S.C. § 553, 554 (1988).

102. Edward R. Leahy, Comment, *Rule-Making And Adjudication In Administrative Policy Making: NLRB v. Wyman-Gordon Co.*, 11 B.C. INDUS. & COM. L. REV. 64, 69 (1969).

103. *Chenery*, 332 U.S. at 203.

104. 5 U.S.C. § 551(4) (1988).

comment procedures.[105] Adjudicative procedures require an adversary proceeding, including notice of the issues, responsive pleading, a hearing and a decision.[106] Adjudicatory rules do not require notice and comment procedures.[107] Standing requirements and the lack of notice and comment prohibit other interested parties from affecting the decision-making process. Theoretically, an adjudicative rule binds only the parties to the action.[108] Since agencies are likely to follow past decisions in a stare decisis manner, however, these "adjudicative decisions take on the status of rules."[109] Although adjudicative rules are considered precedent without specific application to nonparty individuals, "there will be many instances when compliance is expected without further order."[110] Individual case decisions may create either narrow or broad precedential effects.[111]

Quasi-legislative rules have the force of law,[112] while adjudicative rules have the effect of precedent.[113] Agencies may use precedent to distinguish, modify or overrule prior decisions.[114] Subsequently, a nonparty to an agency hearing may be penalized for failing to comply with a prior adjudicative rule.[115] In 1992, the applicability of an adjudicative rule to a nonparty arose in the Tenth Circuit.

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105. *Id.* § 553(b) - (c); *see supra* text accompanying notes 52-57.

106. 5 U.S.C. §§ 554, 556, 557 (1988 & Supp. III 1991). Section 554 grants to private parties the right to adjudication and outlines the required elements of notice to such hearings and the opportunities for presentation provided to the parties. Section 556 outlines government representation and the powers of agency employees at such hearings and assigns the burden of proof. Section 557 addresses initial decisions, agency review of decisions and the record. *Id.*

107. *See* Southwestern Bell Tel. Co. v. Public Util. Comm'n, 745 S.W.2d 918 (Tex. Ct. App. 1988) (discussing when ad hoc rulemaking is a justifiable exception to the general requirement of notice and comment rulemaking); Ron Beal, *Ad Hoc Rulemaking: Texas Style*, 41 BAYLOR L. REV. 101, 128 (1989); Russell L. Weaver, *Chenery II: A Forty-Year Retrospective*, 40 ADMIN. L. REV. 161, 167 (1988). The ability of agencies to create rules without notice and comment procedures has evoked much criticism. *See* Arthur E. Bonfield, *The Federal APA And State Administrative Law*, 72 VA. L. REV. 297, 326-34 (1986); J. Skelly Wright, *The Courts And The Rulemaking Process: The Limits Of Judicial Review*, 59 CORNELL L. REV. 375, 376 (1974).

108. Leahy, *supra* note 102, at 71-72; Beal, *supra* note 98, at 464.

109. Weaver, *supra* note 107, at 200; *see* NLRB v. Wyman-Gordon Co., 394 U.S. 759, 765-66 (1969) (ad hoc rules serve as a guide for future agency decisions); Beal, *supra* note 101, at 464. *But see*, James C. Thomas, *Statutory Construction When Legislation Is Viewed As A Legal Institution*, 3 HARV. J. ON LEGIS. 191, 191-93 (1966).

110. Weaver, *supra* note 107 at 204; *see* Mehta v. INS, 574 F.2d 701, 705 (2d Cir. 1978) (relief denied because petitioner should have been aware of previous agency decision and responded accordingly); Saint Francis Memorial Hosp. v. United States, 648 F.2d 1305, 1311 (Ct. Cl. 1981) (previous agency interpretation of regulation applies to present case).

111. Weaver, *supra* note 107, at 200-01.

112. United States v. Nixon, 418 U.S. 683, 695-96 (1974); Sims v. Heckler, 725 F.2d 1143, 1146 (7th Cir. 1984).

113. NLRB v. Wyman-Gordon Co., 394 U.S. 759, 765-66 (1969); Ruangswang v. INS, 591 F.2d 39, 44 (9th Cir. 1978); American Mach. Corp. v. NLRB, 424 F.2d 1321, 1329-30 (5th Cir. 1970).

114. Weaver, *supra* note 107, at 202-03; Beal, *supra* note 98, at 464.

115. Weaver, *supra* note 107, at 202-03.

B. *Facts: Nunez-Pena v. INS*[116]

In 1987 Ruben Nunez-Pena, a resident alien of the United States, was convicted of illegally using a telephone for drug trafficking and falsifying tax returns to hide drug profits.[117] He was paroled after serving almost two years in prison.[118] The Immigration and Naturalization Service (INS) moved to deport Nunez-Pena.[119] Found deportable by an immigration judge, his application for waiver of deportation was denied.[120] The Board of Immigration Appeals (BIA) reviewed the petitioner's claim under section 212(c) of the Immigration and Nationalization Act (INA).[121] Pursuant to this section, the BIA balanced " 'the adverse factors evidencing an alien's undesirability as a permanent resident with the social and humane considerations presented in his behalf.' "[122] The BIA required the petitioner to " 'introduce additional offsetting favorable evidence, which in some cases may have to involve unusual or outstanding equities,' " in support of his petition to remain in the United States.[123] The BIA affirmed the INS decision ordering Nunez-Pena deported.[124]

C. *The Tenth Circuit Opinion*

Nunez-Pena argued that the BIA improperly required him to meet the "unusual or outstanding equities" test.[125] Normally, the BIA bases its deportability decision on a balance between the alien's undesirability as a resident and the humanistic hardships of deportation.[126] The BIA also uses the unusual or outstanding equities test in cases involving serious criminal acts.[127] Nunez-Pena claimed he was not subject to the outstanding equities rule because the INS had devised it through adjudication and not rulemaking.[128] The court acknowledged that, although other circuits had recognized the outstanding equities principle,[129] the precise argument had not been previously considered.[130]

The Tenth Circuit, by deferring to the agency's application of the outstanding equities rule, upheld the use of adjudicative rules by the

116. 956 F.2d 223 (10th Cir. 1992).
117. *Id.* at 224.
118. *Id.*
119. *Id.* The INS acted pursuant to 8 U.S.C. § 1251 (a)(11) (1988).
120. *Nunez-Pena*, 956 F.2d at 224.
121. *Id.* at 225. This portion of the INA has been utilized for both exclusion and deportation proceedings. *Id.*
122. *Id.* (quoting *In re* Marin, 16 I. & N. Dec. 581, 584 (BIA 1978) (interim dec.)).
123. *Id.* (quoting *In re* Buscemi, 19 I. & N. Dec. 628, 633 (BIA 1988) (interim dec.)).
124. *Id.* at 224.
125. *Nunez-Pena*, 956 F.2d at 225; *see supra* text accompanying note 123.
126. *Id.*
127. *Id.*
128. *Id.*
129. *See* Cordoba-Chaves v. INS, 946 F.2d 1244, 1246-47 (7th Cir. 1991); Blackwood v. INS, 803 F.2d 1165, 1168 (11th Cir. 1986).
130. *Nunez-Pena*, 956 F.2d at 225.

INS. The court reiterated the *Chenery*[131] holding that an agency has the discretion to proceed by general quasi-legislative rule or by individual ad hoc rulemaking through adjudication.[132] Additionally, the court noted that " '[a]djudicated cases may and do . . . serve as vehicles for the formulation of agency policies, which are applied and announced therein.' "[133] The court upheld the outstanding equities standard since "[a]n agency 'is not precluded from asserting new principles in an adjudicative proceeding.' "[134]

The Tenth Circuit did note that the agency's use of adjudicative rulemaking could violate an individual's rights where the INS added an element to a regulation which had been specifically eliminated during prior rulemaking,[135] or where undue hardship resulted to those relying on previous rules when the INS had abruptly changed its rule.[136] The court reasoned that Nunez-Pena had adequate notice of the outstanding equities standard since it had been formulated and applied in adjudications well before his petition.[137]

### D. *Analysis*

Criticism of adjudicative rulemaking centers on the lack of public participation in the rulemaking process and on the lack of notice of new rules. Adjudicative proceedings, like their judicial counterparts, only permit parties to the action to participate.[138] This precludes other interested parties, although affected by a new rule, from participating in the decision-making process. The lack of a requirement for APA notice and comment procedures in adjudicative rulemaking insulates agencies from public participation.

A party's lack of notice of what specific adjudicative precedent may be applied to its particular case is troubling. Since adjudicative rules are easily distinguished and amended, a party may have difficulty preparing their case since "black letter" law does not arise from adjudicative precedent.[139] Subsequently, a party to an adjudicative hearing may find itself in violation of an amended rule that previously did not encompass its operations.

Judicial review of agency action also encourages agencies to use ad-

131. SEC v. Chenery Corp., 332 U.S. 194 (1947); *see supra* text accompanying notes 98-103.

132. *Nunez-Pena*, 956 F.2d at 225. The Tenth Circuit has generally followed *Chenery*. *See*, Nevada Power Co. v. Watt, 711 F.2d 913, 927 (10th Cir. 1983); NLRB v. American Can Co., 658 F.2d 746, 758 (10th Cir. 1981). *But see* First Bancorp v. Board of Governors, 728 F.2d 434, 438 (10th Cir. 1984).

133. *Nunez-Pena*, 956 F.2d at 225 (quoting NLRB v. Wyman-Gordon, 394 U.S. 759, 765 (1969)).

134. *Id.* (quoting NLRB v. Bell Aerospace Co., 416 U.S. 267, 294 (1974)).

135. *Id.* (referring to Patel v. INS, 638 F.2d 1199, 1202 (9th Cir. 1980)).

136. *Id.* (referring to Ruangswang v. INS, 591 F.2d 39, 43-44 (9th Cir. 1978)).

137. *Id.*

138. Weaver, *supra* note 107, at 165. *See generally* NLRB v. Wyman-Gordon Co., 394 U.S. 759 (1969) (agencies should balance the positive and negative attributes of quasi-legislation and adjudication in selecting a decision-making process).

139. Beal, *supra* note 98, at 473.

judicative rulemaking. Agencies find that: (1) rules promulgated through quasi-legislative procedures are more susceptible to judicial scrutiny; (2) adjudicative rules can be amended or overruled more easily than quasi-legislative rules; and (3) adjudicative rules can be retroactive in application.[140] Simply stated, adjudication offers a safer means of rulemaking for an agency.

The Tenth Circuit, or any other court for that matter, is unlikely to restrict application of adjudicative rules, notwithstanding the criticism aimed at the rules. Ad hoc rulemaking allows flexibility, responsiveness and creativity in solving the daily intricacies of administration. The drafters of quasi-legislative rules cannot practically anticipate all possible circumstances. Ambiguity and vagueness in statutes allows agencies to mold decisions under varying circumstances to effectuate fairness. The Supreme Court has stated that "not every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule. Some principles must await their own development, while others must be adjusted to meet particular, unforeseeable situations."[141] *Nunez-Pena* illustrates the Tenth Circuit's deference to an agency's choice of rulemaking procedures and the force of law given to adjudicative rules.

## IV. CONCLUSION

During 1992, the Tenth Circuit favored judicial review of administrative agency decision-making. Although judicial review provided checks against agency discretion, deference to agency decision-making dominated. This deference permeated all areas of administrative decision-making, including an agency's interpretation of its own statute, an agency's determination of whether it was creating substantive law or simply interpreting it and the relatively unfettered ability of agencies to create rules through adjudicative hearings.

*John C. Haas*

140. Leahy, *supra* note 102, at 75.
141. SEC v. Chenery Corp., 332 U.S. 194, 202 (1947).

# ANTITRUST LAW SURVEY

## I. INTRODUCTION

This Survey examines three recent Tenth Circuit opinions that interpret and apply the federal antitrust laws. These cases were selected either because they contained unclear analysis or because the standards articulated were contrary to decisions reached in other courts.

In the first case, *Sharp v. United Airlines, Inc.*,[1] the court of appeals held that employees of an airline allegedly driven into bankruptcy by a competitor lacked standing to assert antitrust claims against the competitor. The court determined that the employees did not establish antitrust injury by their loss of employment and that any possible injury was indirect.

The second case, *City of Chanute v. Williams Natural Gas Co.*,[2] addressed tying arrangements and the essential facilities doctrine as a means of showing antitrust violations in the retail natural gas industry. The Tenth Circuit held that several cities, which had purchased natural gas from the defendant gas company, failed to show a "severe handicap" for purposes of recovery under the essential facilities doctrine. Also, the cities could not prevail on a theory of an illegal tying arrangement between the use of the pipeline and the purchase of gas since they did not show that the gas company had acted in concert with any other entity.

The third case, *TV Communications Network, Inc. v. Turner Network Television, Inc.*,[3] analyzes the proper definition of the relevant market in the monopolization context. The court of appeals held that a cable television programmer could not violate the Sherman Act by virtue of the natural monopoly that it held over its own product. The court refused to accept the plaintiff's characterization of the relevant market as one cable television channel.

This Survey also discusses the implications of the Supreme Court's recent decision, *Eastman Kodak Co. v. Image Technical Services, Inc.*,[4] for these Tenth Circuit cases. In particular, the Survey will focus on the impact of the *Kodak* decision on the standards articulated in *Chanute* regarding tying arrangements, and in *TV Communications Network* regarding the relevant product market.

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1. 967 F.2d 404 (10th Cir.), *cert. denied*, 113 S. Ct. 464 (1992).

2. 955 F.2d 641 (10th Cir.), *cert. denied*, 113 S. Ct. 96 (1992) (*Chanute IV*). This case was part of a series of cases between these parties, which included: City of Chanute v. Williams Natural Gas Co., 678 F. Supp. 1517 (D. Kan. 1988) (*Chanute I*); City of Chanute v. Williams Natural Gas Co., 1990-1 Trade Cas. (CCH) ¶ 68,967 (D. Kan. Feb. 16, 1990) (*Chanute II*); and City of Chanute v. Williams Natural Gas Co., 743 F. Supp. 1437 (D. Kan. 1990) (*Chanute III*). *Chanute IV* affirmed *Chanute II* and *Chanute III*.

3. 964 F.2d 1022 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992).

4. 112 S. Ct. 2072 (1992).

## II. ANTITRUST STANDING

In *Sharp v. United Airlines, Inc.*,[5] the Tenth Circuit analyzed the ability of employees to obtain relief under the antitrust laws for alleged illegal behavior directed at their employer by a competitor. The court rejected such a suit against the competitor primarily because the employees were unable to show antitrust injury, and therefore, lacked standing.[6]

Section 4 of the Clayton Act permits the recovery of damages by any person "injured in his business or property by reason of anything forbidden in the antitrust laws."[7] Section 16 of the Clayton Act entitles any person threatened with "loss or damage by a violation of the antitrust laws" to obtain an injunction.[8] These sections confer on private parties the power to enforce the federal antitrust laws, which primarily consist of the Sherman and Clayton Acts.[9]

Despite the broad language of the Clayton Act, a plaintiff's standing to sue for monetary damages is subject to several limitations. First, the plaintiff must show injury to his business or property.[10] Second, the plaintiff must establish an antitrust injury.[11] Third, the plaintiff's injury must not be too remote.[12] The Supreme Court and the Tenth Circuit have incorporated these general limitations into a multi-factor standard. Courts should consider: the causal connection between the alleged antitrust violation and the harm; the defendant's intent or motivation; whether the claimed injury is one sought to be redressed by antitrust laws; the directness of the connection between the plaintiff's injury and the market restraint resulting from the alleged antitrust violation; the speculative nature of the damages claimed; and the risk of duplicative recoveries or complex damages apportionment.[13] These requirements are questions of law the court must analyze before determining that a plaintiff has standing to sue for antitrust damages.[14]

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5. 967 F.2d 404 (10th Cir.), *cert. denied*, 113 S. Ct. 464 (1992).

6. *Id.* at 407.

7. 15 U.S.C. § 15(a) (1988).

8. *Id.* § 26.

9. The term "any person" includes individuals, partnerships, corporations and associations. *Id.* § 12(a). A successful plaintiff may recover treble damages, costs, reasonable attorney fees, and possibly prejudgment interest. *Id.* § 15(a).

10. *Id.* § 15(a). The Court has construed the term "business" broadly to mean "commercial interests or enterprises." *See* Hawaii v. Standard Oil Co., 405 U.S. 251, 264 (1972).

11. *Sharp*, 967 F.2d at 407 n.2.

12. *Id.*

13. *Id.* at 406-07; *see also* Cargill, Inc. v. Monfort of Colo., Inc., 479 U.S. 104, 122 (1986) (showing of damage or loss "due merely to increased competition does not constitute" antitrust injury); Associated Gen. Contractors v. California State Council of Carpenters, 459 U.S. 519, 544 (1983) (risk of duplicative recoveries and the complexity of apportionment of damges); Blue Shield v. McCready, 457 U.S. 465, 476 (1982) (injury must not be too remote); Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977) (plaintiff must show more than the alleged injury's causal link to the market violation).

14. 955 F.2d 641 (10th Cir.), *cert. denied*, 113 S. Ct. 96 (1992) (*Chanute IV*). Antitrust standing differs from Article III standing, which requires an injury in fact sufficient to satisfy the constitutional jurisdictional requirements. *See, e.g.*, Warth v. Seldin, 422 U.S. 490, 502-08 (1975) (a plaintiff seeking to challenge exclusionary zoning practices must

Although the Tenth Circuit has recently begun to consider the multi-factor standards, it still essentially utilizes a two-prong test to determine standing in antitrust cases.[15] To meet the first prong, the plaintiff must allege an antitrust injury,[16] which is an "injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful."[17] Injury requires a reduction in competition. Thus the Supreme Court has denied relief to plaintiffs whose claimed injury resulted from heightened rather than lessened competition.[18] Courts have found antitrust injury lacking in cases where the plaintiff's injury was deemed to be wholly unrelated to the alleged antitrust violation,[19] or where the defendant's conduct injured the plaintiff but had no effect on competition.[20] Moreover, a violation of antitrust laws without injury to the plaintiff has not been sufficient to confer standing.[21]

Even with the requisite injury, a party may still not be a proper plaintiff under section 4 of the Clayton Act if the injury is too remote.[22] Thus, under the second prong of the Tenth Circuit's antitrust standing test, the plaintiff must show that the antitrust injury resulted *directly* from defendant's violation of antitrust laws.[23] This standard has mainly

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allege specific, concrete facts demonstrating that such practices actually harmed the plaintiff). *See generally* William E. Mooz, Jr., *Tenth Circuit Antitrust Law: Recent Developments and Possible Future Trends*, 69 DENV. U. L. REV. 807, 807-08 (1992) (Article III standing requirements must be satisfied before court can address antitrust standing).

15. *Chanute IV*, 955 F.2d at 652; *see also Sharp*, 967 F.2d at 407 n.2 (the multi-factor standard validates, but gives more specificity to, the inquiry of the Tenth Circuit's two-part test).

16. *Sharp*, 967 F.2d at 407 n.2. Professors Phillip Areeda and Herbert Hovenkamp state that requiring antitrust injury serves two important functions:

> [First, it] forces the parties and the court to reason closely about the nature of the antitrust violation alleged in order to test whether the injury and damages claimed by the plaintiff match the rationale for finding any violation in the first place. . . . The second, and more particular, function of the antitrust injury requirement is to make clear that injuries resulting from [increased] competition will not support either damage or equity actions by private parties under the antitrust laws.

PHILLIP AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 334.2a (Supp. 1992).

17. *Brunswick Corp.*, 429 U.S. at 489. The Court reiterated this requirement in a later decision in which it held that the antitrust injury requirement must be satisfied in private equity suits as well as in damage actions. *Cargill, Inc.*, 479 U.S. at 110-12.

18. *See, e.g.*, Atlantic Richfield Co. v. USA Petroleum Co., 110 S. Ct. 1884, 1891-92 (1990); *Cargill, Inc.*, 479 U.S. at 116; *Brunswick Corp.*, 429 U.S. at 488.

19. *See, e.g.*, Fischer v. NWA, Inc., 883 F.2d 594, 600 (8th Cir. 1989) (losses resulted from elimination of schedule redundancy, not Northwest Airline's acquisition of market power), *cert. denied*, 495 U.S. 947 (1990).

20. *See* ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 652 (3d ed. 1992) (hereinafter ABA ANTITRUST SECTION).

21. Central Nat'l Bank v. Rainbolt, 720 F.2d 1183, 1187 (10th Cir. 1983).

22. *Cargill, Inc.*, 479 U.S. at 110 n.5.

23. *Sharp*, 967 F.2d at 407 n.2; *see also* Reazin v. Blue Cross & Blue Shield, Inc., 899 F.2d 951, 962 n.15 (10th Cir.) ("An injury which is merely causally linked in some way to an alleged antitrust violation is insufficient."), *cert. denied*, 497 U.S. 1005 (1990). The requisite causality requirement has customarily been analyzed under either of two alternative tests: (1) was the plaintiff's injury direct or (2) was the plaintiff within the target area of the defendant's violation. AREEDA & HOVENKAMP, *supra* note 16, ¶ 334a. The target area test required the plaintiff to show that he was within the area of the economy which was endangered by a breakdown of competitive conditions in a particular industry. Confer-

served to deny standing to a plaintiff whose injury was indirect; for instance, when the injury was to a separate party, who was the more immediate victim of the defendant's violation.[24]

Given the Supreme Court's multi-factor considerations for antitrust standing, the Tenth Circuit has recently begun to consider, in addition to the two-prong test, the potential for duplicative or speculative damages and the complexity of apportioning damages.[25] However, while these criteria have been listed and evaluated separately, most decisions turn on the question of antitrust injury,[26] and to a lesser extent, the directness of the injury.

## A. *Antitrust Standing in the Employment Context*: Sharp v. United Airlines, Inc.[27]

### 1. Facts

A group of former pilots, flight attendants, and other employees of Frontier Airlines brought antitrust claims, alleging that United Airlines drove Frontier into bankruptcy. The plaintiffs argued that United had engaged in anticompetitive behavior which caused Frontier to fail, thereby injuring plaintiffs.[28]

Frontier and United were competitors in the volatile airline industry. Each had hub operations at Stapleton International Airport in Denver, Colorado. As part of its operations, United maintained a computerized reservation system (CRS), which enabled travel agents to book and sell tickets on various airlines.[29] Frontier participated in United's CRS, which was one of a number of such systems used in the airline industry.[30]

The employees alleged that United had monopoly power in the Denver CRS market, overcharged Frontier for its participation in the system, and caused the CRS to operate unfairly in its ticket sales to the

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ence of Studio Unions v. Loew's Inc., 193 F.2d 51, 54-55 (9th Cir. 1951), *cert. denied*, 342 U.S. 919 (1952); *see also* Mulvey v. Samuel Goldwyn Prods., 433 F.2d 1073, 1076 (9th Cir. 1970) (plaintiff who sold films to defendant for percentage of subsequent distribution revenues had standing under target area test), *cert. denied*, 402 U.S. 923 (1971). The Sixth Circuit abandoned both the direct injury and target area tests and instead required that the plaintiff allege injury in fact and that "the interest sought to be protected by the complainant was arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question." Malamud v. Sinclair Oil Corp., 521 F.2d 1142, 1151 (6th Cir. 1975). The Supreme Court has yet to adopt any one of the tests. *See McCready*, 457 U.S. at 476 n.12 (noting the varying standing tests developed by the circuits, including "directness of injury," "zone of interests" and "target area" tests, but declining to evaluate or adopt any particular approach); *Associated Gen. Contractors*, 459 U.S. at 536 n.33 (noting different standing tests but refusing to adopt any of them).

24. AREEDA & HOVENKAMP, *supra* note 16, ¶ 334c.

25. *See Sharp*, 967 F.2d at 409-10.

26. ABA ANTITRUST SECTION, *supra* note 20, at 663.

27. 967 F.2d 404 (10th Cir.), *cert. denied*, 113 S. Ct. 464 (1992).

28. *Id.* at 405.

29. *Id.* This particular system consisted of computer terminals located in subscribing travel agencies, was available to these travel agents for a fee and permitted ticket sales on both Frontier and United. *Id.*

30. *Id.*

detriment of Frontier.[31] Plaintiffs also alleged that the decision of United to buy Frontier's assets and to renege on its purchase of Frontier stock[32] caused the airline to fail, costing the plaintiffs their jobs. The plaintiffs asserted that United's conduct violated sections 1 and 2 of the Sherman Act and sections 2 and 3 of the Clayton Act.[33] The trial court granted defendant's motion to dismiss for failure to state a claim upon which relief could be granted.[34]

2. Majority Opinion

On appeal, United argued that the plaintiffs lacked standing to pursue their antitrust claims. The Tenth Circuit agreed, concluding that the employees failed to satisfy the two-prong test, primarily the injury requirement, as well as the other factors associated with antitrust standing.

In attempting to show antitrust injury, the plaintiffs relied on *Adams v. Pan American World Airways, Inc.*[35] In that case, former employees of a defunct airline, Laker Airways, brought antitrust claims alleging that a group of airlines and an airline manufacturer conspired to drive Laker out of business, thereby depriving them of their jobs.[36] The *Adams* court concluded that plaintiffs had alleged an antitrust injury; however, it held that the other relevant factors compelled a finding of no standing.[37]

In *Sharp*, the Tenth Circuit declined to follow the portion of the *Adams* decision supporting the finding that similarly situated airline employees had suffered antitrust injury.[38] The *Adams* decision conflicted with Tenth Circuit precedent. In *Reibert v. Atlantic Richfield Co.*,[39] the Tenth Circuit decided that salaried employees were "not within the area of competitive economy protected against unlawful mergers".[40] In *Jones v. Ford Motor Co.*,[41] the Tenth Circuit indicated that it was settled law that employees did not have standing to sue for antitrust violations

31. *Id.* at 405-06.

32. *Id.* at 406. In particular, plaintiffs argued that the asset sales were distress sales made by Frontier at less than fair market value, and that United purposefully failed to fulfill the stock purchase agreement. *Id.*

33. Plaintiffs also asserted state antitrust claims, breach of contract claims, and a claim that United had intentionally interfered with plaintiffs' prospective business by diverting passengers away from Frontier to United through improper manipulation of the Apollo CRS system. *Id.*

34. *Id.*

35. 828 F.2d 24 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 961 (1988).

36. *Id.* at 24.

37. *Id.* at 26-27. The *Adams* court noted that not only were the employees' injuries one step removed from those of Laker, the immediate victim of the antitrust violation, but that Laker was a superior plaintiff and had in fact brought and settled its own antitrust suit against the same defendants. *Id.* at 29-30.

38. *Sharp*, 967 F.2d at 407.

39. 471 F.2d 727 (10th Cir.), *cert. denied*, 411 U.S. 938 (1973). In *Reibert*, an employee sought treble damages under the Clayton Act for his loss of employment following an allegedly unlawful merger between his employer, Sinclair Oil, and Atlantic Richfield. *Id.* at 727-28.

40. *Id.* at 732.

41. 599 F.2d 394 (10th Cir. 1979).

which had injured their employer.[42]

The plaintiffs in *Sharp* tried to distinguish these cases, arguing that they applied only to employee suits against an employer. The court of appeals rejected this proposition, however, indicating that no such limitation existed. Instead, they stood for the broad proposition that employees could not establish an antitrust injury when they lost their employment "as a result of some allegedly anticompetitive activity directed at or involving their employer."[43] The court concluded that, due to the tangential nature of the injury, the plaintiffs had not established an antitrust injury based on their loss of employment.[44]

Even had the employees established antitrust injury, the *Sharp* court determined that the other factors relevant to standing were not present. Under the second prong of the antitrust standing test, the court analyzed the directness of the connection between the plaintiffs' injuries and the market restraint which had resulted from the alleged antitrust violations.[45] Relying on *Adams*, in which the D.C. Circuit held that the injury the employees suffered was indirect because it was one step removed from the harm to Laker,[46] and prior Tenth Circuit[47] and Supreme Court[48] decisions, the *Sharp* court decided that the plaintiffs' injuries were at most indirect.[49]

Finally, the court analyzed several of the other factors relevant to

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42. *Id.* at 397.

43. *Sharp*, 967 F.2d at 408. The court recognized that a different result may have been reached if the plaintiff-employees were "in essence 'quasi-businessmen operating in a market carved out by their own aggressiveness and salesmanship qualities. Thus when their employers engaged in anti-competitive practices, the employees were directly injured by these violations.' " *Id.* at 408 n.4 (quoting *Reibert*, 471 F.2d at 730). The court concluded that this exception did not apply since plaintiff's injury was "tangential to the direct injury allegedly suffered by Frontier." *Id.* Areeda and Hovenkamp state that they would support antitrust standing where the right of employment is a protected interest within the substantive antitrust violation. "The employment interest is protected by the substantive rules concerned with competition in the plaintiff's labor market but not necessarily by, say, antimerger or price-fixing rules addressed to a product market that is not very closely linked to the plaintiff's labor market." AREEDA & HOVENKAMP, *supra* note 16, ¶ 338a.

44. *Sharp*, 967 F.2d at 408 n.4.

45. *Id.* at 407 n.2, 408-09.

46. Adams v. Pan American World Airways, Inc., 828 F.2d 24, 28 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 961 (1988). The *Adams* court observed that the conspirators allegedly forced the firm to its knees. "Whenever that happens to a firm, the web of contracts and relationships which form the essence of the firm will be dismantled. Astute counsel should not be able, merely by feats of characterization, to confer standing on all participants in that web." *Id.*

47. *See* Jones v. Ford Motor Co., 599 F.2d 394, 397 (10th Cir. 1979) (direct injury does not include the loss of a job with a corporation or a reduction in an investment in stock); Reibert v. Atlantic Richfield Co., 471 F.2d 727, 731 (10th Cir.) ("If there is any antitrust violation, it is directed toward the petroleum industry. . . . The first element, causal connection between violation and injury, is lacking because [plaintiff] cannot show that any antitrust violations directly injured him."), *cert. denied*, 411 U.S. 938 (1973).

48. *See* Air Courier Conference of Am. v. American Postal Workers Union, 111 S. Ct. 913, 920 n.5 (1991) ("Employees have generally been denied standing to enforce competition laws because they lack competitive and direct injury."); Associated Gen. Contractors, Inc. v. California State Council of Carpenters, 459 U.S. 519, 541 n.6 (1983) (Court observed that "a number of decisions have denied standing to employees with merely derivative injuries.")

49. *Sharp*, 967 F.2d at 409.

antitrust standing: the potential for duplicative or speculative damages and the complexity of apportioning damages. In the exceptionally volatile airline industry, characterized by frequent mergers and bankruptcies, an airline's survival or the continued employment of employees was too indefinite to calculate damages.[50] In addition, allowing employees to have standing would risk duplicative recoveries or the necessity of apportioning damages.[51] In summation, the *Sharp* decision indicated that employees, who lost their employment as the result of some anticompetitive activity directed at or involving their employer, lacked standing in the Tenth Circuit to assert federal and state antitrust claims against their former employer's competitor.

3. Analysis

In *Sharp*, the court correctly rejected plaintiffs' claim that antitrust injury resulted from their loss of employment. Although not explicitly articulating its rationale, the court apparently decided that the alleged antitrust violation occurred in the air transportation and CRS markets, but that the alleged injury was in the employment market. As members only of the employment market, the plaintiffs were unable to establish antitrust injury because the violation occurred in the air transportation and CRS markets, not the employment market. Rather than broadly holding that employees never have standing, this decision actually indicates that as long as the alleged antitrust violation occurred in another market, employees will not be able to establish antitrust injury, regardless of the severity of their actual injury. If in fact the violation occurred in the employment market, it is probable that employees would have standing.

The motivating factor behind the court's decision appears to be a concern for unlimited plaintiffs and rampant litigation. The court noted that if it were to permit standing in this case, "there would be no principled way to cut off a myriad of other indirect claimants, such as suppliers of Frontier Airlines or creditors, each of whom could claim that their business was somehow impacted or adversely affected by Frontier's demise."[52] Moreover, the court's outcome is consistent with other decisions, which generally deny standing to employees, officers or stockholders of a corporation injured by an antitrust violation.[53] Since the injury to the plaintiffs was merely derivative of the injury to their

50. *Id.* The wholeness of each plaintiff would have depended on the length of their employment, future salary level, and ability to obtain comparable employment in the airlines industry. *Adams*, 828 F.2d at 30.

51. *Sharp*, 967 F.2d at 410. In addition, the court rejected plaintiffs' argument that, despite dismissal of their complaint for lack of standing under the federal antitrust laws, the court should permit their state law antitrust claims to proceed. *Id.*

52. *Id.* at 409.

53. *See, e.g.*, Southwest Suburban Bd. of Realtors, Inc. v. Beverly Area Planning Ass'n, 830 F.2d 1374, 1378 (7th Cir. 1987) (officer of corporation); Eagle v. Star-Kist Foods, Inc., 812 F.2d 538, 541-42 (9th Cir. 1987) (employees); Loeb v. Eastman Kodak Co., 183 F. 704, 709 (3d Cir. 1910) (stockholder); Weatherby v. RCA Corp., 1988-1 Trade Cas. (CCH) ¶ 68,078 (N.D.N.Y. May 9, 1986) (shareholders, employees).

employer, the court correctly held that such employees lacked standing to sue their employer's competitor for an alleged antitrust violation.

## III. REFUSALS TO DEAL AND RESTRAINTS OF TRADE

The Tenth Circuit analyzed the elements of tying arrangements and the essential facilities doctrine in *City of Chanute v. Williams Natural Gas Co.*[54] The court held, in a proposition unique to the Tenth Circuit, that a contract involving only a customer and the seller cannot constitute an illegal tying arrangement.[55] In addition, the court applied the essential facilities doctrine and concluded that the natural gas purchasers did not suffer a "severe handicap" since the gas company offered the gas at federally approved prices.[56]

Congress enacted the Sherman Act as a means of safeguarding general competitive conditions rather than protecting specific competitors.[57] This concern was reiterated in the language of the Sherman Act. Section 1 prohibits contracts, combinations and conspiracies in restraint of trade.[58] Section 2 of the Sherman Act proscribes certain monopolies, attempts to monopolize and conspiracies to monopolize.[59] These two sections focus on different problems: section 1 deals with concerted activity; section 2 concerns unilateral activity.[60]

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54. 955 F.2d 641 (10th Cir.), *cert. denied*, 113 S. Ct. 96 (1992) (*Chanute IV*).

55. *Id.* at 650.

56. *Id.* at 648-49.

57. *See, e.g.*, Oahu Gas Serv., Inc. v. Pacific Resources Inc., 838 F.2d 360, 370 (9th Cir.), *cert. denied*, 488 U.S. 870 (1988). The Supreme Court has succinctly stated the purpose of the Sherman Act:

> The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition.

Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 4 (1958).

58. 15 U.S.C § 1 (1988). Section 1 of the Sherman Act states, in relevant part, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." *Id.* Both criminal and civil sanctions may be imposed for § 1 violations. In addition, violations of § 1 may be enjoined pursuant to § 16 of the Clayton Act, 15 U.S.C. § 25 (1988), and persons injured in their business or property by reason of a violation may recover treble damages under § 4 of the Clayton Act, 15 U.S.C. § 15 (1988).

59. *Id.* § 2. Section 2 of the Sherman Act states:

> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by fine not exceeding one million dollars if a corporation, or, if any other person, one hundred thousand dollars, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

15 U.S.C. § 2 (1988).

60. Alaska Airlines, Inc. v. United Airlines, Inc., 948 F.2d 536, 540-41 (9th Cir. 1991), *cert. denied*, 112 S. Ct. 1603 (1992).

### A. *Restraints of Trade: Tying Arrangements*

Section 1, read literally, would prohibit all concerted activity in restraint of trade.[61] The Supreme Court, however, has construed this section to condemn only those restraints that unreasonably restrict competition.[62]

Tying arrangements represent one form of restraint that can violate section 1. A tying arrangement is "an agreement by a party to sell one product [the tying product] but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."[63] A form of exclusive dealing, a tying arrangement restricts the purchaser's freedom to buy products from sources other than the seller.[64] Usually the seller requires the buyer to purchase or lease a different product as a condition of the purchase. The product may be complementary or supplementary to the originally supplied item or may be completely unrelated.[65]

An element of an illegal tying arrangement requires proof of two separate and distinct products.[66] The availability of one product or service must be conditioned upon the purchase of another.[67] The seller must also have the market power to "force" the purchaser to act differently than it would in a competitive market.[68]

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61. National Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 687-88 (1978).

62. Standard Oil Co. v. United States, 221 U.S. 1, 58 (1911).

63. *Northern Pac. Ry. Co.*, 356 U.S. at 5-6. This decision has met with recent approval by the Supreme Court in Eastman Kodak Co. v. Image Technical Servs., Inc., 112 S. Ct. 2072, 2079 (1992).

64. The *Northern Pacific* court articulated the competitive harm resulting from tying arrangements:

> [Tying arrangements] deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in another market. At the same time buyers are forced to forgo their free choice between competing products.

*Northern Pac. Ry. Co.*, 356 U.S. at 6.

65. 2 LOUIS ALTMAN & RUDOLF CALLMANN, THE LAW OF UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 10.18, at 104 (4th ed. 1985 & 1992 Supp.). Often tying arrangements are employed to boost the sales of a particular product that lacks demand. *Id.*

66. Jefferson Parish Hosp. v. Hyde, 466 U.S. 2, 21 (1984) (it is "clear that a tying arrangement cannot exist unless two separate product markets have been linked."). Altman lists four criteria used in determining the relation or distinction of two products: (1) trade usage or practice in the field; (2) sale of a consistently homogeneous combination of the two products; (3) lump sum billing for the combination; and (4) existence of other related products not included in the unit. 2 ALTMAN & CALLMAN, *supra* note 65, § 10.18, at 106.

67. United States v. Loew's Inc., 371 U.S. 38, 45 (1962); *see Northern Pac. Ry. Co.*, 356 U.S. at 6 n.4 ("where the buyer is free to take either product by itself there is no tying problem.").

68. *Jefferson Parish Hosp.*, 466 U.S. at 13-14; *see also Eastman Kodak Co.*, 112 S. Ct. at 2079 (noting that a violation occurs "if the seller has 'appreciable economic power' in the tying product market and if the arrangement affects a substantial volume of commerce in the tied market") (citations omitted); Fox Motors, Inc. v. Mazda Distributors, Inc., 806 F.2d 953, 957 (10th Cir. 1986) (finding that tying arrangement violates the antitrust laws when a dominant seller exploits his control over a market to force buyers to purchase an unwanted product).

Generally, courts will decide that a tying arrangement violates the antitrust laws if: (1) the probable effect is to "substantially lessen competition or tend to create a monopoly in any line of commerce;"[69] (2) if it results in an unreasonable restraint that effects a substantial amount of interstate commerce;[70] or (3) if it is shown to be "in conflict with the basic policies" of the antitrust laws.[71] Courts have generally found anticompetitive tying arrangements unlawful per se.[72]

### B. *Refusals To Deal: Essential Facilities Doctrine*

While section 1 of the Sherman Act prohibits only contracts, combinations and conspiracies in restraint of trade, section 2 prohibits unilateral monopolization and attempted monopolization, as well as monopolization by combination or conspiracy.[73] To enforce this prohibition in refusal to deal cases, courts have looked to the essential facilities doctrine.[74] Established by the Supreme Court only twenty-two

69. A violation of section 3 of the Clayton Act, 15 U.S.C. § 14 (1988). Section 3, in relevant part, forbids any person:

> [T]o lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented . . . or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, *where the effect* of such lease, sale, or contract for sale or such condition, agreement, or understanding *may be to substantially lessen competition or tend to create a monopoly in any line of commerce.*

*Id.* (emphasis added).

Because § 3 of the Clayton Act only applies when both the tying and tied products are "goods, wares, merchandise, machinery, supplies or other commodities," tying arrangements involving such intangibles as medical services, credit, business and personal services, and trademarks or franchises cannot be challenged under § 3, although they still may be challenged under § 1 of the Sherman Act and § 5 of the FTC Act. ABA ANTITRUST SECTION, *supra* note 20, at 133-34.

70. A violation of section 1 of the Sherman Act, 15 U.S.C. § 1 (1988).

71. A violation of section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1988). Section 5, in relevant part, provides: "(1) Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful." *Id.*

72. *See, e.g.*, Fortner Enters. v. United States Steel Corp., 394 U.S. 495, 503 (1969) (tying arrangements "generally serve no legitimate business purpose that cannot be achieved in some less restrictive way."); Standard Oil Co. v. United States, 337 U.S. 293, 305-06 (1949) (such arrangements "serve hardly any purpose beyond the suppression of competition."); International Salt Co. V. United States, 332 U.S. 392, 396 (1947) ("it is unreasonable, *per se*, to foreclose competitors from any substantial market.") The American Bar Association Antitrust Section notes that while tying arrangements are classified as per se illegal, "the test used to determine whether the per se rule should be applied to a particular arrangement is in practice very similar to a rule of reason inquiry, because a number of market related inquiries must be conducted before the per se rule is applied." ABA ANTITRUST SECTION, *supra* note 20, at 134.

73. 15 U.S.C. § 2 (1988).

74. 955 F.2d 641 (10th Cir.), *cert. denied*, 113 S. Ct. 96 (1992) (*Chanute IV*). A second, unrelated test that courts use in refusal to deal cases under § 2 of the Sherman Act is the intent test, which states that a "business is free to deal with whomever it pleases so long as it has no 'purpose to create or maintain a monopoly.' " Byars v. Bluff City News Co., 609 F.2d 843, 855 (6th Cir. 1979) (quoting United States v. Colgate & Co., 250 U.S. 300, 307 (1919)); *see also* Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985) (applying the intent test when considering the circumstances under which a firm with mo-

years after Congress enacted the Sherman Act,[75] the essential facilities doctrine acknowledges that a business controlling a scarce resource has a duty or obligation to allow reasonable access to the facility, even for competitors.[76] Monopolists must make their facilities available on a nondiscriminatory basis where a competitor cannot, in an economically feasible manner, duplicate the facility.[77]

The Tenth Circuit and other courts of appeals have adopted standards to determine whether a monopolist's action violates the essential facilities doctrine. An antitrust plaintiff must show: "(1) control of the essential facilities by a monopolist; (2) a competitor's inability practically or reasonably to duplicate the facility; (3) the denial of the use of the essential facilities to a competitor; and (4) the feasibility of providing the facility."[78] The plaintiff must demonstrate the presence of each element; if even one element is missing, the doctrine is unavailing.[79] This test differs from traditional monopolization analysis by de-emphasizing intent and instead focusing on the surrounding market conditions.[80]

### C. *The Essential Facilities Doctrine and Tying Arrangements in the Natural Gas Industry*: City of Chanute v. Williams Natural Gas Co.[81]

#### 1. Facts

The plaintiffs, eight cities in Kansas (Cities) that operate their own natural gas distribution systems, sued the defendant, Williams Natural Gas Company, asserting antitrust violations. Specifically, the Cities protested Williams' termination of a temporary program that allowed the purchase of gas from third-party suppliers, which Williams transported over its pipeline.[82]

Williams owned and operated the only interstate pipeline serving the Cities. Each of the Cities had "full requirements" contracts with the pipeline company. These contracts required the Cities to purchase all of their natural gas from Williams, which in turn agreed to ensure the avail-

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nopoly power has a duty to continue a joint marketing arrangement with a smaller competitor).

75. *See* United States v. St. Louis Terminal R.R. Ass'n, 224 U.S. 383, 410 (1912). The Court found the practice of fourteen railroads, which denied access to certain railway bridges crossing the Mississippi, violated the antitrust laws as a restraint of trade. The defendants were required to allow competing railroads use of their facilities which were, as a practical matter, impossible to duplicate. *Id.*

76. Aspen Highlands Skiing Corp. v. Aspen Skiing Co., 738 F.2d 1509, 1519 (10th Cir. 1984), *aff'd on other grounds*, 472 U.S. 585 (1985).

77. McKenzie v. Mercy Hosp., 854 F.2d 365, 369 (10th Cir. 1988).

78. *Id.* (citing MCI Communications Corp. v. American Tel. & Tel. Co., 708 F.2d 1081, 1132-33 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983)).

79. *McKenzie*, 854 F.2d at 370; *see id.* at 371 (essential facilities doctrine unavailing since doctor failed to demonstrate the first element: that hospital controls facilities essential to his medical practice).

80. City of Chanute v. Williams Natural Gas Co., 678 F. Supp. 1517, 1531 (D. Kan. 1988) (*Chanute I*).

81. 955 F.2d 641 (10th Cir.), *cert. denied*, 113 S. Ct. 96 (1992) (*Chanute IV*).

82. *Id.* at 645.

ability of a sufficient supply to meet the Cities' demands.[83] Initially, Williams only transported its own gas over the pipeline, pursuant to the full requirements contract. In December 1986, however, the gas company sought regulatory approval from the Federal Energy Regulatory Commission (FERC) to permit the transportation of gas from third-party suppliers on a permanent basis. While awaiting approval, Williams initiated a temporary program to transport third-party gas for the Cities, which then negotiated with, and entered into agreements for, gas from other suppliers. The temporary program was allowed by FERC.[84]

While the temporary program was in effect and the Cities were purchasing third-party gas, Williams experienced difficulty paying its suppliers.[85] Williams ended the program and closed its pipeline to the alternate suppliers in August 1987, although it continued to transport certain third-party gas.[86] In July 1988, FERC approved Williams' permanent plan, which enabled the Cities to purchase gas from any third-party supplier. Thereafter, the Cities negotiated with other suppliers to obtain gas, which Williams transported over its pipeline.

The Cities brought suit under sections 1 and 2 of the Sherman Act, alleging that Williams' conduct in closing its pipeline was an exercise of its monopoly power, which injured the Cities by preventing them from receiving transportation of a long-term, dependable supply of low-cost natural gas from third-party suppliers over the pipeline.[87] The Cities sought antitrust damages for the time period, from August 1987 until July 1988, during which Williams had closed its pipeline to the transportation of third-party gas until approval of the permanent plan.

Specifically, the Cities claimed that Williams' refusal to transport gas unless the Cities purchased Williams' gas constituted an illegal tying arrangement.[88] The Cities asserted that the requirements contracts tied natural gas transportation (tying product) to natural gas sales (tied product).[89] They also contended that Williams had the market power to

83. *Id.* at 646. The Cities purchased natural gas at wholesale and resold it to customers located in or near the Cities. *Id.*

84. *Id.* Otherwise the full requirements contracts would have precluded the Cities from purchasing gas from third party suppliers even if Williams agreed to transport the gas over its pipeline. The waiver did not release Williams from its obligation to serve the Cities' full requirements on demand. *Id.*

85. *Id.* Apparently Williams had take-or-pay provisions in its contracts with the natural gas suppliers. These provisions obligated Williams to pay for certain volumes of gas even though it was unable to sell that amount to its customers. *Id.* at 646 n.4.

86. *Id* at 646. The Cities presented evidence concerning Williams' decision to close the pipeline. One expert testified that Williams closed its pipeline to control access to the pipeline, to maintain a large portion of its sales function, and to increase profits. Another economist stated that Williams experienced a significant erosion in its sales of natural gas as customers converted to transported gas, that Williams earned a higher margin on sales than it did on transportation, and that Williams ended its open access "in order to prevent this loss of market share, and in order to prop up the price that it received for its product." *Id.* at 654. Even though Williams ended the temporary program, FERC required Williams to transport certain third-party gas that was still available to the Cities. *Id.* at 646 n.5.

87. City of Chanute v. Williams Natural Gas Co., 743 F. Supp. 1437, 1440 (D. Kan. 1990) (*Chanute III*).

88. *Chanute IV*, 955 F.2d at 649-50.

89. *Id.* at 650.

"force" the Cities to do something they would not have done in a competitive market.[90] The district court granted summary judgment for Williams, deciding that the Cities failed to show any agreement between two or more parties and that Williams did not force the Cities to buy its natural gas.[91]

The Cities also alleged that Williams' decision to close the pipeline violated section 2 of the Sherman Act under the essential facilities doctrine.[92] The Cities contended: that Williams was a monopolist in control of the pipeline that was essential to competition in the retail natural gas market; that the Cities were unable to duplicate, practically or reasonably, the pipeline access; that Williams denied the Cities use of the pipeline; and that it was feasible for Williams to have provided the Cities with access to the pipeline.[93] The district court granted summary judgment for Williams, holding that the Cities were unable to establish the second and third elements: the Cities' inability to duplicate the facility, and Williams' denial of use of the facility to the Cities.[94]

2. Majority Opinion

The Cities appealed the district court's granting of summary judgment. In particular, the Cities alleged that Williams' actions violated section 1 of the Sherman Act as an illegal tying arrangement and section 2 of that act under the essential facilities doctrine.[95]

With respect to the tying claim, the Cities asserted that the district court erred by not finding the existence of the necessary agreement between parties. They contended that the requirements contracts between Williams and the Cities constituted the necessary agreement. The Cities also argued that the approved third-party suppliers' gas did not provide a defense to Williams forcing the sale of its natural gas.[96]

The Tenth Circuit rejected these arguments. Rather, the court of appeals reaffirmed its decision in *McKenzie v. Mercy Hospital*,[97] that section 1 of the Sherman Act did not prohibit a tying arrangement imposed by a single entity.[98] In *McKenzie*, the plaintiff asserted that an arrangement which linked two separate and distinct product markets together was sufficient proof of a tying arrangement. The *McKenzie* court disagreed, deciding that the plaintiff must make a preliminary showing of a

90. *Id.*; *see* Jefferson Parish Hosp. v. Hyde, 466 U.S. 2, 13-14 (1984).

91. City of Chanute v. Williams Natural Gas Co., 1990-1 Trade Cas. (CCH) ¶ 68,967, 63,206 (D. Kan. Feb. 16, 1990) (*Chanute II*).

92. *Chanute IV*, 955 F.2d at 647.

93. *Id.*

94. *Id.* at 648.

95. *Id.* The Cities also contended that the full requirements contracts themselves violated the antitrust laws, thereby entitling the Cities to treble damages under § 4 of the Clayton Act. *See id.* at 651-53. In addition, the Cities asserted a monopolization claim under § 2 of the Sherman Act. *Id.* at 653-56.

96. *Id.* at 650.

97. 854 F.2d 365 (10th Cir. 1988). In *McKenzie*, the court acknowledged that a single entity could establish a tying arrangement; however, the court decided that such an arrangement was not proscribed by section 1 of the Sherman Act. *Id.* at 368.

98. *Chanute IV*, 955 F.2d at 650.

conspiracy between two persons.[99] The Tenth Circuit applied this standard and indicated that the Cities needed to show that the alleged tying arrangement resulted from concerted activity between separate parties.[100]

The Cities did provide evidence to establish that Williams tied its natural gas to its transportation facilities. They did not, however, show that Williams acted in concert with any other entity. In fact, the Cities named only themselves as the other party to the alleged conspiracy. Therefore, the court of appeals decided that summary judgment was appropriate because the Cities failed to make the requisite preliminary showing of a conspiracy necessary for their section 1 tying claim.[101]

With respect to the essential facilities doctrine, the court of appeals held that the Cities failed to meet their burden since they failed to establish the second and third elements of the test.[102] They did not show that Williams provided access to the pipeline on such unreasonable terms as to constitute a denial of access.[103] The Cities did not suffer a severe handicap as a result of Williams having provided the Cities' full requirements of natural gas rather than transporting third-party gas.[104] The court reasoned that Williams' supply of gas at FERC approved prices provided the Cities with reasonable access to the pipelines. Such reasonable access defeated the second element of the test since reasonable access was equivalent to practical duplication.[105] Reasonable access also defeated the third element — denial of use of the facilities. Since the Cities failed to prove the second and third elements, they did not meet their burden of presenting evidence that Williams denied or limited access to its pipeline solely to gain a competitive edge. Thus the Tenth Circuit upheld the decision to grant summary judgment for Williams on the section 2 claim.[106]

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99. *McKenzie*, 854 F.2d at 367-68. According to the *McKenzie* decision, a violation of section 1 required " 'unlawful conduct by two or more parties pursuant to an agreement. . . . Solely unilateral conduct, regardless of its anticompetitive effects, is not prohibited by Section 1.' " *Id.* at 367 (quoting Contractor Utility Sales Co. v. Certain-Teed Prods. Corp., 638 F.2d 1061, 1074 (7th Cir. 1981), *cert. denied*, 470 U.S. 1029 (1985)).

100. *Chanute IV*, 955 F.2d at 650.

101. *Id.* at 650-51.

102. *Id.* at 648. The Cities asserted as error that the district court ignored its own findings made at the preliminary hearing, that the evidence showed the facility could not be physically duplicated and that the approved third-party suppliers' gas was not a feasible substitute for other third-party gas. The Tenth Circuit rejected these arguments. The fact the Cities prevailed at the preliminary injunction stage was not determinative in a summary judgment proceeding. *Id.*

103. *Id.*

104. *Id.*

105. *Id.* at 649.

106. *Id.* In addition, the court of appeals granted summary judgement in favor of Williams on all other causes of action. The court determined that: (1) the Cities failed to establish a monopolization claim in light of Williams' showing that its action was the result of a legitimate business decision, *id.* at 653-56; and (2) the Cities failed to show antitrust injury for purposes of standing, since Williams was not obligated to provide access to the other suppliers in the first place, *id.* at 651-53.

3. Concurrence

Judge Seymour, in her concurrence, disagreed with the majority's reliance on *McKenzie* as support for the proposition that section 1 did not apply to a tying arrangement imposed by a single entity.[107] Rather, under the case law of the Tenth Circuit and other circuits, a buyer alleging that he had been coerced or forced by a seller into an illegal tying arrangement stated the requisite combination or conspiracy under the Sherman Act.[108] The concurrence pointed to several cases to support this position. In *Black Gold, Ltd. v. Rockwool Industry*,[109] the Tenth Circuit Court of Appeals stated that a plaintiff who contended that a seller unlawfully refused to deal as a means of enforcing an anticompetitive practice, such as tying or price-fixing, could have established the requisite combination or conspiracy by showing that he himself unwillingly complied with the practice.[110] On rehearing, where the defendant urged the court to reconsider its conclusion that the record contained evidence of a tying conspiracy, the court indicated that a combination occurs between a seller and buyers whose acquiescence in the seller's firmly enforced restraints was induced by "the communicated danger of termination."[111]

The concurrence noted that the Cities alleged that Williams illegally tied the purchase of natural gas to its transportation and that they were forced to accept the arrangement because they had no alternative source. However, since Williams' gas was sold at FERC approved prices, and given that the Cities could have obtained cheaper third-party gas throughout this period, Williams could not have forced the Cities to acquiesce.[112] Only because the Cities failed to state facts from which the trier could have found forcing did the concurrence conclude that summary judgement was appropriate on the tying claim.

4. Analysis

In rejecting the Cities' tying claim, the majority held that a tying arrangement imposed by a single entity did not violate section 1 of the Sherman Act since there was no conspiracy between independent parties. This statement misinterprets the section 1 contract, combination or conspiracy requirement. Most courts that have considered the issue have found agreement between the seller and the buyer sufficient to es-

107. *Id.* at 658 (Seymour, J., concurring). Judge Seymour indicated that *McKenzie* was factually distinguishable, and therefore not controlling, because in that case the plaintiff himself did not and could not agree to the illegal arrangement. *Id.* at 658 n.1. Judge Seymour agreed with most of the majority opinion, including the decision reached under the essential facilities doctrine. However, she disagreed with the majority's analysis of the antitrust standing and antitrust injury issue. *See id.* at 659-60.

108. *Id.* at 658-59.

109. 729 F.2d 676, 686 (10th Cir. 1984).

110. *Id.* The *Black Gold* court relied on United States v. Parke, Davis and Co., 362 U.S. 29 (1960), for this statement.

111. *Chanute IV*, 955 F.2d at 659.

112. *Id.*

tablish the requisite conspiracy.[113] They have not required evidence that a separate third party conspired with the seller. As the concurring opinion noted, even Tenth Circuit precedent indicated that a single entity could prove the requisite combination or conspiracy "by showing that he himself *unwillingly complied* with the practice, or by showing that although he refused to acquiesce, other buyers agreed to the arrangement under threat of termination."[114]

A subsequent district court opinion underscored the problem with *Chanute* and *McKenzie*. By requiring proof of the "archetypical conspiracy to maintain a Section 1 claim . . . [these cases] seemingly erase the words 'contract' and 'combination' . . . from Section 1. Contracts in restraint of trade [between a customer and seller] are thereby effectively removed from Section 1's reach, even though embraced by its express terms."[115]

Applying the more recognized standard could have resulted in a different outcome if the Cities had alleged sufficient facts to support the finding of a tying arrangement. Whereas the plaintiff in *Black Gold* refused to buy goods under the alleged unlawful tying arrangement, and could not base the requisite combination or conspiracy on any agreement it had with the defendant,[116] the Cities potentially bought goods under the alleged tying arrangement and, therefore, could base the requisite combination or conspiracy on an agreement they had with Williams.

The recent Supreme Court decision, *Eastman Kodak Co. v. Image Technical Services, Inc.*,[117] supports the conclusion that a buyer who alleges that he has been forced by a seller into an illegal tying arrangement has stated the requisite combination or conspiracy under section 1 of the Sherman Act.[118] The Supreme Court determined that a reason-

113. *Black Gold, Ltd.*, 729 F.2d at 686; *see* Smith Mach. Co. v. Hesston Corp., 878 F.2d 1290, 1294 (10th Cir. 1989) (noting that although a dealer refused to accede to manufacturer's request, the dealer could have shown an agreement between manufacturer and other dealer), *cert. denied*, 493 U.S. 1073 (1990); *see also* Perma Life Mufflers Inc. v. International Parts Corp., 392 U.S. 134, 142 (1968) ("petitioner can clearly charge a combination between Midas and himself, as of the day he unwillingly complied with the restrictive franchise agreements . . . ."); Albrecht v. Herald Co., 390 U.S. 145, 150 n.6 (1968) ("petitioner could have claimed a combination between respondent and himself, at least as of the day he unwillingly complied with respondent's advertised price."); Will v. Comprehensive Accounting Corp., 776 F.2d 665, 670 (7th Cir. 1985) (finding that "unwilling compliance" between franchisees and franchisor satisfied the joint action requirement of section 1), *cert. denied*, 475 U.S. 1129 (1986). *But cf.* Systemcare, Inc. v. Wang Lab., Inc., 787 F. Supp. 179 (D. Colo. 1992) (court constrained to follow Tenth Circuit's erroneous requirement of concerted action between separate parties).

114. *Chanute IV*, 955 F.2d at 659 (Seymour, J., concurring) (citing *Black Gold, Ltd.*, 729 F.2d at 686) (emphasis in original).

115. *Systemcare, Inc.*, 787 F. Supp. at 182.

116. *Black Gold, Ltd.* 729 F.2d at 686.

117. 112 S. Ct. 2072 (1992).

118. *See Chanute IV*, 955 F.2d at 658-59 (Seymour, J., concurring). In *Eastman Kodak Co.*, after independent service organizations began servicing copying and micrographic equipment manufactured by Kodak, Kodak adopted policies to limit the availability to the independent service organizations of replacement parts for its equipment and to make it more difficult for those companies to compete with Kodak in servicing such equipment.

able trier of fact could find, first, that service and parts were two distinct products in light of evidence indicating that each had been, and continued in some circumstances to be, sold separately; and second, that Kodak tied the sale of the two products in light of evidence indicating that it sold parts to third parties only if they agreed not to buy service from the independent service organizations.[119] The Court rejected Kodak's characterization of the sale as a unilateral refusal to deal.[120] Implicit in the analysis, third-party conspirators could bring a tying claim based on an agreement between Kodak and themselves. *Eastman Kodak Co.*, therefore, supports the proposition that a buyer who was forced into an illegal tying arrangement can state the requisite combination or conspiracy by showing that he himself complied with the practice.

With respect to the essential facilities claim, the *Chanute* court purported to apply the four-part test. However, the court actually relied on a separate severe handicap standard to analyze both the second and third elements: the Cities' inability to reasonably duplicate the pipeline access; and Williams' denial of access to the pipeline. Since the Cities suffered no severe handicap they failed to establish both the second and third elements.[121]

The court's analysis, and the four-part test itself, would have been more accurate if the severe handicap standard had been applied to the second element only, not the third. The first element, the monopolist's control of the essential facility, and the third element, the denial of access to the essential facility, focus on the nature of the conduct itself. Under the second element, the competitor's inability to duplicate access to the facility, and the fourth element, the feasibility of providing the competitor access to the facilities, the court analyzes the effect of that conduct on competition. As a practical way to analyze the detrimental effect on competition, the severe handicap standard asks whether the inability to duplicate the facilities imposed a severe handicap on competition.[122] Because it focuses on the effect the described conduct has on competition, not on the nature of the conduct itself, the severe handicap standard really only answers the questions posed in the second and fourth elements. By limiting its use of the severe handicap standard to these elements, the Tenth Circuit would clarify its analysis under the essential facilities doctrine.

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The independent service organizations brought suit, alleging that Kodak had unlawfully tied the sale of service for its machines to the sale of parts, in violation of section 1 of the Sherman Act. *Eastman Kodak Co.*, 112 S. Ct. at 2077-78.

119. *Eastman Kodak Co.*, 112 S. Ct. at 2079-80.

120. *Id.* at 2080 n.8.

121. *Chanute IV*, 955 F.2d at 648-49.

122. Other circuits have applied a severe handicap standard to determine the effect of denial of access. *See* Alaska Airlines, Inc. v. United Airlines, Inc., 948 F.2d 536 (1991) (holding that a successful essential facilities plaintiff must prove that denial of access caused it "severe handicap"), *cert. denied*, 112 S. Ct. 1603 (1992); Twin Laboratories, Inc. v. Weider Health & Fitness, 900 F.2d 566 (2nd Cir. 1990); Hecht v. Pro-Football, Inc., 570 F.2d 982, 992 (D.C. Cir. 1977), *cert. denied*, 436 U.S. 956 (1978).

## IV. MONOPOLIZATION - THE RELEVANT MARKET

In *TV Communications Network, Inc. v. Turner Network Television, Inc.*,[123] the Tenth Circuit Court of Appeals determined that the plaintiff could not establish section 2 monopolization claims because of its failure to define properly the relevant market. Because it defined the relevant market as a single product, the plaintiff failed, as a matter of law, to allege a relevant market that the defendant was capable of monopolizing.[124]

The Supreme Court usually defines the offense of unlawful monopolization as the possession of monopoly or market power, plus deliberate conduct intended to acquire, use, or preserve that power.[125] The primary dilemma facing courts is that many of the same methods that may be used to acquire or maintain monopoly power, such as charging lower prices, exercising discretion when choosing customers, and introducing new products, are also the kinds of competitive strategies that the antitrust laws are designed to encourage.[126]

Traditionally, the Supreme Court has defined monopoly or market power as "the power to control market prices or to exclude competition."[127] In the Tenth Circuit, however, monopoly power requires both control over prices *and* the ability to exclude competition.[128] Since the ability to control prices ultimately depends on the absence of competition, the distinction is probably more theoretical than real.[129]

An essential step to determining a company's market power is to define the relevant market in which the power over prices or competition is to be appraised.[130] The relevant market is the "area of effective competition" within which the defendant operates.[131] The purpose in defining the relevant market is "to identify the firms that compete with each other in a given product and geographic area in order to determine

123. 964 F.2d 1022 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992).

124. *Id.* at 1025.

125. Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 596 n.19 (1985).

126. ABA ANTITRUST SECTION, *supra* note 20, at 196.

127. United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377, 391 (1956); *see also* NCAA v. Board of Regents of Univ. of Okla., 468 U.S. 85, 109 n.38 (1984) (stating that market power is the "ability to raise prices above those that would be charged in a competitive market").

128. Shoppin' Bag, Inc. v. Dillon Cos., 783 F.2d 159, 164 (10th Cir. 1986); *accord* Reazin v. Blue Cross & Blue Shield, 899 F.2d 951, 966-67 (10th Cir.), *cert. denied*, 497 U.S. 1005 (1990). The Third, Fifth, Sixth, Eighth and D.C. Circuits have also required both elements. *See* ABA Antitrust Section, *supra* note 20, at 196-97 n.8 (citing Borough of Lansdale v. Philadelphia Elec. Co., 692 F.2d 307, 311 (3d Cir. 1982); Deauville Corp. v. Federated Dep't Stores, Inc., 756 F.2d 1183, 1188 (5th Cir. 1985); Richter Concrete Corp. v. Hilltop Concrete Corp., 691 F.2d 818, 826 (6th Cir. 1982); National Reporting Co. v. Alderson Reporting Co., 763 F.2d 1020, 1024 (8th Cir. 1985); Neumann v. Reinforced Earth Co., 786 F.2d 424, 430 (D.C. Cir.), *cert. denied*, 479 U.S. 851 (1986)).

129. ABA ANTITRUST SECTION, *supra* note 20, at 196-97.

130. City of Chanute v. Williams Natural Gas Co., 955 F.2d 641, 654 (10th Cir.) *cert. denied*, 113 S. Ct. 96 (1992) (*Chanute IV*); *see also* Walker Process Equip., Inc. v. Food Mach. & Chem. Corp., 382 U.S. 172, 177 (1965) ("Without a definition of that market there is no way to measure [an alleged monopolist's] ability to lessen or destroy competition.")

131. Tampa Elec. Co. v. Nashville Coal Co., 365 U.S. 320, 327-28 (1961).

whether other firms can effectively constrain the price of the alleged monopolist."[132] A properly defined relevant market normally identifies both the relevant product market and the relevant geographic market.[133]

The relevant product market includes those products that are "reasonably interchangeable by consumers for the same purposes."[134] In determining the reasonable interchangeability of products, courts consider the cross-elasticity of demand, which measures "the responsiveness of the sales of one product to price changes of the other."[135] For example, a relevant market defined in terms of user substitutes includes "producers of identical products, of products with physical or brand differences entirely disregarded by consumers, and of products regarded by consumers as such close substitutes that a slight relative price change in one will induce intolerable shifts of demand away from the other."[136] The latter products have a high cross-elasticity of demand and are presumptively in the same relevant product market.[137]

Relevant product markets generally cannot be limited to a manufacturer's own products, or to a single class of purchasers.[138] In *United*

132. ABA ANTITRUST SECTION, *supra* note 20, at 198. Professors Areeda and Hovenkamp indicate that courts generally define the relevant market in terms of the legal issue before the court: whether a defendant firm possesses monopoly power; whether a merger of competitors creates a substantial risk that the resulting firm will either acquire power over price or may be able to coordinate prices with its rivals at non-competitive levels; or whether a transaction will reinforce any such threats to competition. AREEDA & HOVENKAMP, *supra* note 16, ¶ 518.1.

133. *Chanute IV*, 955 F.2d at 654.

134. Bacchus Indus., Inc. v. Arvin Indus., Inc., 939 F.2d 887, 893 (10th Cir. 1991); *see E.I. du Pont de Nemours & Co.*, 351 U.S. at 404 ("That market is composed of products that have reasonable interchangeability for the purposes for which they are produced - price, use and qualities considered.")

135. *E.I. du Pont de Nemours & Co.*, 351 U.S. at 400; *see also* Westman Comm'n Co. v. Hobart Int'l, Inc., 796 F.2d 1216, 1220-21 (10th Cir. 1986) (analyzing cross-elasticity of demand), *cert. denied*, 486 U.S. 1005 (1988). Elasticity and inelasticity of demand relate to the freedom of demand within the relative product market. In an elastic market, buyers are able to chose freely what products they wish to buy. In an inelastic market, buyers are limited in their choices due to inadequate selections and excessive prices. These factors are important with respect to the court's determination of the relevant product market and the optimum cross-elasticity of demand, which is the extent to which a consumer is able to shift freely between two or more products. 16A JULIAN O. VON KALINOWSKI, BUSINESS ORGANIZATIONS: ANTITRUST TRADE LAWS AND TRADE REGULATION § 6G.04[1], 6G-37 (1991).

136. AREEDA & HOVENKAMP, *supra* note 16, ¶ 525a.

137. *Id.*

138. Many courts have determined that the relevant market cannot consist of a single manufacturer's product. *See, e.g.*, Town Sound & Custom Tops, Inc. v. Chrysler Motors Corp., 959 F.2d 468 (3d Cir.) (finding that in an alleged tying arrangement, the relevant market was all automobiles manufactured in the United States, not merely the automobile manufacturer's own brand), *cert. denied*, 113 S. Ct. 196 (1992); International Logistics Group v. Chrysler Corp., 884 F.2d 904 (6th Cir. 1989) (Chrysler's own brands not relevant market), *cert. denied*, 494 U.S. 1066 (1990); Telex Corp. v. IBM, Corp., 510 F.2d 894 (10th Cir.) (relevant market was all peripheral computer equipment, not merely those that were plug-compatible with IBM central processing units), *cert. dismissed*, 423 U.S. 802 (1975); Christianson v. Colt Indus. Operating Corp., 766 F. Supp. 670 (C.D. Ill. 1991) (M16 assault rifle not a relevant market since there were numerous competing products); Sun Dun, Inc. v. Coca-Cola Co., 740 F. Supp. 381 (D. Md. 1990) (rejecting claim that defendant could be guilty of monopolizing the distribution of its own brand of soft drink); Carlock v. Pillsbury Co., 719 F. Supp. 791 (D. Minn. 1989) (manufacturer's own brand of ice

*States v. E.I. du Pont de Nemours & Co.*, the Court indicated that manufactures should not ordinarily be deemed to have monopolized their own products.[139] However, some courts have found the relevant product market to be limited to the products of a single supplier where they are so unique as to have no reasonably interchangeable substitutes.[140]

The relevant geographic market is defined as "the narrowest market which is wide enough so that products from adjacent areas . . . cannot compete on substantial parity with those included in the market."[141] This fact-intensive determination involves an analysis of how far consumers are willing travel to obtain the product at a lower price.[142]

Both the relevant geographic and product markets "can be determined only after a factual inquiry into the 'commercial realities' faced by consumers."[143] It is the plaintiff's burden to prove the relevant market, and the evidence must set forth some basis to support the plaintiff's defi-

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cream not a relevant market); Disenos Artisticos E Industriales, S.A. v. Work, 714 F. Supp. 46 (E.D.N.Y. 1989) (manufacturer's brand of porcelain figurines could not be relevant market); Theatre Party Assocs. v. Shubert Org., 695 F. Supp. 150 (S.D.N.Y. 1988) (Broadway theatre's own popular show not a relevant market; relevant market likely included all Broadway shows, ballet, and perhaps even sporting events); Hendricks Music Co. v. Steinway, Inc., 689 F. Supp. 1501 (N.D. Ill. 1988) (refusing to recognize "concert and artist" pianos, in which only Steinway and Yamaha pianos participated, as a distinct market).

139. 351 U.S. 377, 393 (1956). The *du Pont* Court noted that:

> [O]ne can theorize that we have monopolistic competition in every non-standardized commodity with each manufacturer having power over the price and production of his own product. However, this power that, let us say, automobile or soft-drink manufacturers have over their trademarked products is not the power that makes an illegal monopoly. Illegal power must be appraised in terms of the competitive market for the product.

*Id.* (citations omitted).

140. Eastman Kodak Co. v. Image Technical Servs., Inc., 112 S. Ct. 2072, 2090 (1992); *see also* Parts and Elec. Motors, Inc. v. Sterling Elec., Inc., 866 F.2d 228 (7th Cir. 1988) (finding market power in own brand of electric motors for tie-in purpose), *cert. denied*, 493 U.S. 847 (1989); National Ass'n of Pharmaceutical Mfrs., Inc. v. Ayerst Lab., 850 F.2d 904 (2d Cir. 1988) (suggesting that a particular branded drug, Inderal, could be a relevant market); Bushie v. Stenocord Corp., 460 F.2d 116, 121 (9th Cir. 1972) (defendant's own differentiated products can constitute a relevant market if they are "so unique or so dominant in the market in which they compete that any action by the manufacturer to increase his control over his product virtually assures that competition in the market will be destroyed."); *cf.* Tunis Bros. Co. v. Ford Motor Co., 952 F.2d 715 (3d Cir. 1991) (although a single brand could conceivably be a relevant market, plaintiff did not meet burden of showing that Ford tractors were not reasonably interchangeable with the tractors of competitors), *cert. denied*, 112 S. Ct. 3034 (1992).

141. *Westman Comm'n Co.*, 796 F.2d at 1222 (citations omitted). The outer boundary of the relevant geographic market is reached, "if one were to raise the price of the product or limit its volume of production, while demand held constant, and supply from other sources beyond the boundary could not be expected to enter promptly enough and in large enough quantities to restore the old price or volume." Satellite Television & Assoc. Resources, Inc. v. Continental Cablevision, Inc., 714 F.2d 351, 356 (4th Cir. 1983), *cert. denied*, 465 U.S. 1027 (1984) (citations omitted). The Supreme Court noted that: "The geographic market selected must . . . both 'correspond to the commercial realities' of the industry and be economically significant. Thus, although the geographic market in some instances may encompass the entire Nation, under other circumstances it may be as small as a single metropolitan area." Brown Shoe Co. v. United States, 370 U.S. 294, 336-37 (1962) (citations omitted).

142. *See Westman Comm'n Co.*, 796 F.2d at 1222.

143. *Eastman Kodak Co.*, 112 S. Ct. at 2090 (*quoting* United States v. Grinnell Corp., 384 U.S. 563, 572 (1966)). Each market is defined from the perspective of the buyer, not the seller. *See Westman Comm'n Co.*, 796 F.2d at 1221.

nition of the relevant product market.[144] The proper definition is generally a question for the trier of fact, and summary judgment is typically inappropriate because the pertinent economic facts are usually disputed. In some instances, however, the relevant market may be determined as a matter of law, particularly in cases where the relevant economic facts are not in dispute.[145] Properly defining the relevant market is often the key to a plaintiff's case under the Sherman Act.[146]

### A. *The Relevant Market in Denver Cable Television*: TV Communications Network, Inc. v. Turner Network Television, Inc.[147]

#### 1. Facts

Plaintiff, TV Communications Network (TVCN), provided cable television for a fee to subscribers in metropolitan Denver, Colorado. While most cable television operators distributed their programming through coaxial cable, TVCN was a wireless cable operator that utilized microwave transmission technology.[148] Defendant Turner Network Television (TNT) manufactured, produced and supplied video programming, including National Premium Sports Programming.[149] Since 1988, TNT has refused to allow TVCN to receive its programming in order for TVCN to offer it to its subscribers.[150] TVCN discovered that

144. *See* Tarabishi v. McAlester Regional Hosp., 951 F.2d 1558, 1568 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 2996 (1992).

145. *See, e.g.*, Key Fin. Planning Corp. v. ITT Life Ins. Corp., 828 F.2d 635, 643 (10th Cir. 1987); Domed Stadium Hotel, Inc. v. Holiday Inns, Inc., 732 F.2d 480, 487 (5th Cir. 1984).

146. ABA ANTITRUST SECTION, *supra* note 20, at 197-98. Over the past two decades, the courts have expanded the requirement that an antitrust plaintiff engage in a proper market power analysis, which means that virtually all antitrust cases now require some proof of market power. Mooz, *supra* note 14, at 811. *See, e.g.*, Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co., 472 U.S. 284, 294-95 (1985) (market power analysis required for rule of reason analysis in horizontal group boycott); Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12-18 (1984) (market power analysis required for tying arrangements); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36, 58-59 (1977) (non-price vertical restraints analyzed under rule of reason, which requires a determination of market power); United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966) (section 2 monopolization and attempt to monopolize claims require a properly defined relevant market). However, market power analysis is not required for per se violations of the antitrust laws. *See* Reazin v. Blue Cross & Blue Shield, 899 F.2d 951, 968 n.24 (10th Cir.), *cert. denied*, 497 U.S. 1005 (1990).

147. 964 F.2d 1022 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992).

148. *Id.* at 1023. Cable Television was "deregulated" in 1984. Cable Communications Policy Act of 1984, 47 U.S.C. § 521 (1988). For an article regarding cable industry franchise agreements, see Daniel L. Brenner, *Was Cable Television a Monopoly?*, 42 FED. COMM. L.J. 365 (1989).

149. *TV Communications Network, Inc.*, 964 F.2d at 1023. There were several other original defendants, including ESPN, Capital Cities/ABC, Tele-Communications, United Artists Entertainment Co., American Television and Communications Corp., Scripps Howard Cable Company, Scripps Howard Communications, and Mile High Cable Co., all of which settled out of court. *Id.* at 1023 n.1.

150. *Id.* at 1024. TVCN alleged that TNT refused to let it carry TNT programming because the wireless system posed a competitive threat to conventional cable systems. TVCN claimed cable programmers and system owner conspired to squeeze it out of business because it encroached on some systems' franchise areas. Adriel Bettelheim, *High Court Rejects Cable TV Lawsuit*, DENV. POST, Dec. 1, 1992, at C1.

many potential subscribers would not subscribe until TVCN made the TNT channel available. In addition, existing subscribers threatened to terminate their subscription if the TNT channel was not made available.[151]

TVCN filed the complaint to force TNT to make its programming available to TVCN. The district court dismissed the plaintiff's complaint for failure to state a claim upon which relief could be granted.[152]

2. Majority Opinion

TVCN appealed, asserting monopolization, attempt to monopolize, and conspiracy to monopolize claims under section 2 of the Sherman Act.[153] To establish a monopolization claim, TVCN must have shown "the possession of monopoly power in the relevant market" and "the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident."[154] An actionable attempt to monopolize claim required a properly defined relevant market, a dangerous probability of success in monopolizing the relevant market, the specific intent to monopolize, and conduct in furtherance of such an attempt.[155] A conspiracy to monopolize required the existence of a combination or conspiracy to monopolize the relevant market.[156] Therefore, all three of the section 2 claims required a properly defined relevant market.[157]

In defining the relevant market, TVCN's complaint alleged that TNT monopolized the market for the TNT channel in Denver. TVCN claimed that TNT had complete control and a 100% market share of the TNT market.[158] The Tenth Circuit rejected this market definition. Relying on *E.I. du Pont de Nemours & Co.*,[159] the court of appeals deter-

151. *TV Communications Network*, 964 F.2d at 1024.

152. *Id.*

153. *Id.* at 1024-27. The plaintiff also sought relief under § 1 of the Sherman Act for the alleged conspiracy between TNT and other cable operators. *Id.* at 1027. The court rejected the § 1 claim, holding that TVCN could not establish § 1 claims against TNT based on price fixing, a group boycott, or refusal to deal. *Id.* at 1027-28. In addition, the court dismissed the plaintiff's state law claims without prejudice following the dismissal of the federal claims. *Id.* at 1028.

154. United States v. Grinnell Corp., 384 U.S. 563, 570-71 (1966).

155. *TV Communications Network*, 964 F.2d at 1025.

156. *See id.* at 1026. In addition to proving the existence of a combination or conspiracy to monopolize, a plaintiff must prove three other elements in order to establish a claim for conspiracy to monopolize: overt acts done in furtherance of the combination or conspiracy; an effect upon an appreciable amount of interstate commerce; and a specific intent to monopolize. *Id.*

157. In addition to defining a relevant market for section two claims, a section one plaintiff, utilizing the rule of reason standard, who cannot prove actual detrimental effects on competition must properly define the relevant market. *See* Reazin v. Blue Cross & Blue Shield, 899 F.2d 951, 968 n.24 (10th Cir.), *cert. denied*, 497 U.S. 1005 (1990) ("there must be sufficient evidence supporting the jury's finding of an agreement which unreasonably restrained trade *in the relevant market*") (emphasis added) (footnote omitted); *see also* Kaplan v. Burroughs Corp., 611 F.2d 286, 291 (9th Cir. 1979) ("Proof that the defendant's activities had an impact upon competition in a relevant market is an absolutely essential element of the rule of reason case."), *cert. denied*, 447 U.S. 924 (1980).

158. *TV Communications Network*, 964 F.2d at 1025.

159. 351 U.S. 377, 393 (1956). The court also relied on Key Fin. Planning Corp. v.

mined that TVCN failed to allege a relevant market which TNT was capable of monopolizing because "a company does not violate the Sherman Act by virtue of the natural monopoly it holds over its own product."[160]

TVCN's definition of the relevant product market as one cable programmer's channel was defective as a matter of law.[161] Because it did not allege a relevant market that TNT was capable of monopolizing in violation of the antitrust laws, TVCN could not prove that TNT had a dangerous probability of success of monopolizing the relevant market. Based on the improperly defined market, the court affirmed the district court's dismissal of the monopolization, attempt to monopolize, and conspiracy to monopolize claims.[162]

3. Analysis

While the *TV Communications Network* court's holding that a relevant product market cannot be a single manufacturer's product is consistent with many other decisions, a recent Supreme Court decision indicates that a single brand of a product can constitute a relevant product market in certain circumstances.[163] In *Eastman Kodak Co.*, the Court disagreed with Kodak's contention that, as a matter or law, a single brand of a product or service could never be a relevant market under the Sherman Act.[164] Rather, the relevant market "is determined by the choices available to Kodak equipment owners,"[165] who were the consumers. The Supreme Court concluded that, since services and parts for Kodak equipment were not interchangeable with those of other manufacturers, the relevant market from the Kodak equipment owner's perspective was

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ITT Life Ins. Corp., 828 F.2d 635, 643 (10th Cir. 1987), in which the Tenth Circuit held that the defendant's life insurance policies did not constitute a relevant market, even though the defendant paid higher advances to its agents than other insurers. The *Key Financial Planning Corp.* court reasoned that nothing restrained competing insurers from increasing their advances, if they needed to do so in order to retain good agents or make more sales. *Id.*

160. *TV Communications Network*, 964 F.2d at 1025; *see Key Fin. Planning Corp.*, 828 F.2d at 643.

161. *TV Communications Network*, 964 F.2d at 1025. On appeal and contrary to the allegations in its amended complaint, TVCN asserted that the market for the TNT channel was not the relevant market to consider. Rather, TVCN alleged that the relevant product market was subscription television programming or sports programming. However, the court, stating that the amended complaint must stand or fall on its own, rejected this assertion as a futile mischaracterization of the allegations in the amended complaint. *Id.*

162. *Id.* at 1028. Although not specifically rejecting the section 2 conspiracy to monopolize claim for failure to properly define the relevant product market, the court mentioned the improperly defined market as a factor in the dismissal of the conspiracy to monopolize claim. *Id.* Under its conspiracy to monopolize claim, TVCN alleged that the overt acts and specific intent to monopolize were evidenced by denial of access to essential facilities for the relevant TNT channel market in Denver, fixing prices, a group boycott, unreasonable territorial allocations and exclusionary measures. *Id.* at 1026. The court decided that TVCN failed on its conspiracy claim since the compliant did not provided facts to support a conspiracy claim and did little more than recite the relevant antitrust laws. *Id.* at 1026-27.

163. Eastman Kodak Co. v. Image Technical Servs., Inc., 112 S. Ct. 2072, 2090 (1992).

164. *Id.*

165. *Id.* (citations omitted).

composed of only those companies that serviced Kodak machines.[166]

Moreover, *Eastman Kodak Co.* essentially repudiated the *TV Communications Network* court's reliance on *E.I. du Pont de Nemours & Co.* as justification for invalidating a relevant market comprised of a single brand of a product. In a footnote, the Court implicitly discouraged such use of *du Pont*. It pointed out that the *du Pont* Court did not *reject* the notion that a relevant market could be limited to one brand. "The Court simply held in *du Pont* that one brand does not *necessarily* constitute a relevant market if substitutes are available. Here respondents contend there are no substitutes."[167] Thus the recent Supreme Court decision invalidated the basis for part of the *TV Communications Network* holding and likely abrogated the Tenth Circuit's decision that a single product cannot, as a matter of law, constitute a relevant market.[168]

Factually, *TV Communication Network* would be similar to *Eastman Kodak Co.* if TVCN, like the respondents in *Eastman Kodak Co.*, provided sufficient evidence that there were no substitutes for the TNT channel. But unlike *Eastman Kodak Co.*, where Kodak equipment owners were forced to purchase only Kodak replacement parts, TVCN was not forced into a situation where it had to buy TNT. Moreover, there was no evidence that other sport programming was unavailable or unsatisfactory to potential subscribers. Therefore, the two cases are factually distinguishable and, although the Tenth Circuit's broad statement that a single product cannot as a matter of law constitute the relevant market is clearly not true, summary judgment was probably still appropriate.

## V. CONCLUSION

In *Sharp*, the Tenth Circuit determined that employees of an airline allegedly driven into bankruptcy by another airline lacked standing to assert antitrust claims against the competitor. In evaluating antitrust standing, the Tenth Circuit utilized its two-part test, which required antitrust injury resulting directly from the antitrust violation, and for the first time, analyzed the other elements mentioned in the Supreme Court's multi-factor standard. The court held that the employees did not establish antitrust injury by their loss of employment because any injury was indirect, the damages were speculative, and there was risk of duplicative recoveries if the employees were allowed standing. Essentially the case indicated that as long as the alleged antitrust violation occurred in a market other than the employment market, the employees could not establish antitrust injury.

The *Chanute* case addressed the use of the essential facilities doc-

166. *Id.*

167. *Id.* at 2090 n.30 (citations omitted) (emphasis in original).

168. *Cf.* Smalley & Co. v. Emerson & Cuming, Inc., 808 F. Supp. 1503 (D. Colo. 1992) (recognizing that a single product might constitute the relevant product market, but declining to extend *Eastman Kodak Co.* to allow a single product sold to a single customer, given uncontested evidence of other consumers of that product, to represent the relevant product market).

trine and tying claims in the natural gas industry. The court held that several cities which purchased natural gas from the gas company failed to show "severe handicap" and therefore could not recover under the essential facilities doctrine. To make its analysis of the four-part essential facilities test less confusing, the court should have only applied the severe handicap standard to the second element of the test: the inability to duplicate reasonably access to the facility.[169]

The majority in *Chanute* also stated that section 1 of the Sherman Act did not prohibit a tying arrangement imposed by a single entity. However, as the concurrence noted, the requisite conspiracy, or combination could exist between the seller and a buyer when the buyer was forced to agree to the arrangement. The Tenth Circuit needs to reevaluate its position and recognize the possibility that acquiescence by the buyer establishes the requisite conspiracy.

Finally, in *TV Communications Network*, the Tenth Circuit invalidated the plaintiff's definition of the relevant product market. Section 2 monopolization, attempt to monopolize, and conspiracy to monopolize claims require the plaintiff to properly define the relevant markets, which include both product and geographic markets. The plaintiff defined the relevant product market as a single cable television channel. The court rejected such a narrow definition as a matter of law, holding that "a company does not violate the Sherman Act by virtue of the natural monopoly it holds over its own product."[170] However, a recent Supreme Court decision that a single brand can constitute a relevant product market if there are no available substitutes limits this broad Tenth Circuit precedent. While the result in the *TV Communications Network* decision would probably have been the same after *Eastman Kodak Co.*, the Tenth Circuit should allow for the possibility that a single product could constitute the relevant product market under the right circumstances.

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169. This standard should also be applied to the fourth element, however, the court did not analyze this element.

170. TV Communications Network, Inc. v. Turner Network Television, Inc., 964 F.2d 1022, 1025 (10th Cir.), *cert. denied*, 113 S. Ct. 601 (1992) (citations omitted).

# CIVIL PROCEDURE SURVEY

## OVERVIEW

The Tenth Circuit decided three timely and significant cases in the course of calendar year 1992. In *Securities and Exch. Comm'n v. Thomas*,[1] the Tenth Circuit, in light of the increasing number of pro se litigants and the problems they create, held a pro se litigant to the same requirements of an ordinary litigant in regards to raising error on appeal. Displaying its diminishing tolerance for the growing number of discovery abuses, the court also levied the harsh, but increasingly more common, sanction of dismissal for a party's non-attendance at his own deposition in *Ehrenhaus v. Reynolds*.[2] Finally, recognizing the popular defendants' tactic of tying up litigation through endless venue transfer motions, the court upheld a venue transfer motion denial in *Scheidt v. Klein*,[3] despite factors that closely suggested transfer might have been appropriate.

Part I discusses the growing number of pro se litigants and the concerns they raise with special attention given to their duties on appeal. Part II looks critically at the options a court has available in order to deal with discovery abusers, most specifically the harsh sanctions of default and dismissal. Part III reviews the methods by which defendants seek changes in venue and the difficult burdens they must bear in order to effect a change or appeal a refusal of change.

## I. PRO SE LITIGANTS AND THEIR BURDEN ON APPEAL: *SECURITIES AND EXCH. COMMISSION V. THOMAS*

### A. *Background*

#### 1. Pro Se Litigants Generally

With legal services quickly becoming priced beyond the reach of potential litigants, many plaintiffs are deciding to enter the courtroom pro se, or unrepresented. These plaintiffs suffer many disadvantages, procedurally and otherwise. Legal necessities like causation and damages are frequently beyond their thoughts. One who possesses no legal knowledge not only faces problems but also creates problems for others wrestling with his or her inadequacies, which may be significant at the pre-trial, trial and appellate stages.[4] Pro se litigants' pleadings may be filled with examples of technical ignorance, sometimes purposeful, of the rules governing their pleadings, motions and deadlines.[5] Many pro se plaintiffs are litigation seekers, shopping for a favorable forum, im-

1. 965 F.2d 825 (10th Cir. 1992).
2. 965 F.2d 916 (10th Cir. 1992).
3. 956 F.2d 963 (10th Cir. 1992).
4. Paul B. Zuydhoek, *Litigation Against a Pro Se Plaintiff*, 15:4 LITIGATION 13 (1989).
5. For an overview of the rules governing a party's conduct in the federal court system, see Title 28, United States Code — Judiciary and Judicial Procedure.

posing numerous filings for improper purposes such as harassment and remaining blissfully unconcerned with opponents' discovery requests. More than one court has grown plainly indignant with the number of frivolous pro se filings.[6] These litigants have been able to get away with conduct that the court would not have tolerated from a represented party.

This conduct manifests itself most strongly in the appellate arena. The number of pro se appellate filings has increased substantially[7] and many of these are filed without proper support in the form of procedural requirements or substantive accompaniments. One federal court of appeals has voiced its concern over the large number of frivolous pro se appeals.[8] But at the same time, the judiciary is cognizant of the difficult and often lengthy appellate process that a pro se litigant faces.[9] Scholars recognize the handicapped status of such an appellant[10] and to this end, the Clerk for the Federal Circuit publishes and distributes a handbook entitled "Guide to Pro Se Petitioners and Appellants."[11]

Courts evaluate a pro se litigant's conduct in a light dependent upon the stage of litigation. At the complaint stage, the Supreme Court holds pro se complainants to "less stringent standards" than attorneys and that dismissal at the pleading stage is inappropriate unless it is "beyond [a] doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."[12] The judiciary recognizes that dismissals for pleading rule violations threaten both a pro se litigant's constitutional right of access to the courts and their statutory right of self-representation in civil cases[13] and will liberally construe complaints in their favor.

> A layman cannot be expected to realize as quickly as a lawyer would that a legal position has no possible merit, and it would be as cruel as it would be pointless to hold laymen who cannot afford a lawyer . . . to a standard of care that they cannot attain even with their best efforts.[14]

This liberal view does not end with the filing of a complaint, as the

6. *See, e.g.*, Bombalski v. United States, No. 91-285, 1991 U.S. Dist. LEXIS 16854, (W.D. Pa. Oct. 29, 1991), *aff'd*, 972 F.2d 1330 (3d Cir. 1992).

7. *See* Statistical Report of the Sixth Circuit as of June 30, 1990, Table 4a (covering specifically the Sixth circuit), *cited in* Judith Resnik, *Housekeeping: The Nature and Allocation of Work in Federal Trial Courts*, 24 GA. L. REV. 909, 928 (1990).

8. Gabel v. Lynaugh, 835 F.2d 124 (5th Cir. 1988).

9. Chief Judge Howard T. Markey, The Sixth Annual Judicial Conference of the United States Court of Appeals for the Federal Circuit, 122 F.R.D. 281 (1989).

10. Allen R. Prunty and Mark E. Solomons, Note, *Federal Black Lung Update*, 92 W. VA. L. REV. 849, 880 (1990).

11. Federal Circuit Rules of Practice Before the United States Court of Appeals for the Federal Circuit (1990). For further discussion on the difficulties pro se litigants face, see Burton R. Laub, *The Problem of the Unrepresented, Misrepresented and Rebellious Defendant in Criminal Court*, 2 DUQ. L. REV. 245 (1964); Maurice M. Garcia, Comment, *Defense Pro Se*, 23 U. MIAMI L. REV. 551 (1969).

12. Haines v. Kerner, 404 U.S. 519, 520-21 (1972).

13. *In re* Green, 669 F.2d 779, 785 (D.C. Cir. 1981).

14. Bacon v. American Fed'n of State, County and Mun. Employees, 795 F.2d 33, 35 (7th Cir. 1986).

courts allow pro se complainants to amend their pleadings "fairly freely."[15]

Notice and service are treated differently by the courts. In a case brought by a pro se litigant, twice failing to serve certain defendants forced dismissal of his suit. The court stated:

> [W]hile we are not unmindful of the special difficulties which confront pro se litigants, [Plaintiff], like all parties to litigation, cannot rely on his pro se status as a shield from all mistakes but must at some point bear the consequences of his procedural errors.[16]

Once filing is completed, the pro se plaintiff's status is not yet secured—the D.C. Circuit holds that a pro se party must receive special notice that failure to oppose a summary judgment motion will result in a judgment being entered against the pro se,[17] but the Ninth circuit disagrees.[18] Courts have dismissed pro se cases for failure to prosecute, but in one case only after the pro se failed to appear for deposition four times and was sternly warned of the pending dismissal.[19]

Courts may sanction the pro se litigant in any number of ways.[20] They are more likely to sanction a pro se litigant's misconduct when the litigant had actual notice of the meaning of procedural rules.[21] Even absent notice, however, a pro se litigant is still subject to Federal Rule of Civil Procedure 11 requiring that the party's pleadings be signed, certifying that the pleading is not interposed for any improper purpose.[22] The court is *obligated* to sanction any violations of Rule 11 "whether plaintiff is represented by counsel or, as here, brings his action pro se."[23]

The threshold the litigant must cross before being sanctioned varies. A court recently did not impose sanctions on a complaint even though it was "utterly frivolous", because no court had previously sanctioned the pro se plaintiff before.[24] Another court suspended a sanction order and gave the pro se complainant a chance to explain why she rea-

15. Holmes v. Godin, 615 F.2d 83, 85 (2d Cir. 1980). Any jury demand must generally be made within ten days of service of the last pleading that addresses an issue for which trial by jury is sought. FED. R. CIV. P. 38(b). A pro se plaintiff, however, is not held to strict compliance with that rule. Merritt v. Faulkner, 697 F.2d 761, 766 (7th Cir.), *cert. denied*, 464 U.S. 986 (1983).

16. Michelson v. Merrill Lynch, Inc., 619 F. Supp. 727, 741-42 (S.D.N.Y. 1985).

17. Hudson v. Hardy, 412 F.2d 1091 (D.C. Cir. 1968).

18. Jacobsen v. Filler, 790 F.2d 1362 (9th Cir. 1986).

19. Hepperle v. Johnson, 590 F.2d 609 (5th Cir. 1979). At trial, pro se litigants are treated the same as any other with no relaxation of evidentiary rules. Andrews v. Bechtel Corp., 780 F.2d 124, 140 (1st Cir. 1985), *cert. denied*, 476 U.S. 1172 (1986).

20. One should note that in civil rights actions at least one court has declined to impose sanctions because "[m]any people not trained in the law believe the Constitution provides broader civil rights protection than it in fact does." Redfield v. Wood, No. 1:90-CV-61, 1990 U.S. Dist. LEXIS 16176 (W.D. Mich. Nov. 30, 1990).

21. Mitchell v. Inman, 682 F.2d 886 (11th Cir. 1982).

22. Nixon v. Phillipoff, 615 F. Supp. 890 (N.D. Ind. 1985).

23. Sparrow v. Reynolds, 646 F. Supp. 824, 839 (D.D.C. 1986).

24. Scheck v. General Elec. Corp., No. Civ. A. No. 91-1594, 1992 WL 13219 (D.D.C. Jan. 7, 1992).

sonably believed that her complaint had merit.[25] One court goes so far as to require a "showing of malice" before sanctioning a pro se litigant.[26] Sanctioning is universal and not restricted to the federal district court system.[27]

2. Pro Se Litigants in the Appeals Process

Appellate courts give a great deal of scrutiny to a pro se litigant's filing of actions. Courts require pro se petitioners to take full responsibility for the propriety of their appeals.[28] A pro se's claim that the trial court allowed "a gang of criminals" to prevail was met with sharp criticism from the appellate judge who required the offender to show why double costs and reasonable attorney fees should not be assessed.[29]

It is federally mandated that a party be sanctioned for frivolous appeals.[30] One circuit court cast a jaundiced eye upon a pro se plaintiff's second attempt at their tax protest appeal, since the earlier claim had been rejected and plaintiffs had received a stern warning from that circuit to "throw in the towel."[31] "In the second round of what the [pro se party] apparently would like to make a fifteen round bout, we affirm and impose further sanctions which will hopefully result in a knockout punch to the litigation."[32] The stakes in the appellate process are also higher. Appellate courts uphold sanctions in amounts ranging upward of $100,000,[33] despite the pro se's proceeding *in forma pauperis*.[34] In addition to fees and costs, sanctions range from loss of commissary privileges for prisoners[35] to outright dismissal of the claim.[36]

Pro se appellants are afforded somewhat greater protection than attorney-represented appellants, but this protection is not free-ranging

25. Louisville v. Armored Transp. of California, No. C-90-0266 RCP, 1991 U.S. Dist. LEXIS 2523 (N.D. Cal. Feb. 26, 1991).

26. Cooper v. Adair, 1989 WL 50805 (E.D.N.Y. May 8, 1989), *aff'd*, 930 F.2d 909 (2d Cir. 1991).

27. *See, e.g.*, Casper v. Commissioner of I.R.S., 805 F.2d 902, 906 (10th Cir. 1986) (Tax Court upheld sanctions against unrepresented party).

28. Lewis v. Lenc-Smith Mfg. Co., 784 F.2d 829 (7th Cir. 1986) (requiring pro se to sign notice of appeal).

29. Mullen v. Galati, 843 F.2d 293 (8th Cir. 1988).

30. FED. R. APP. PROC. 38. *See, e.g.*, Lefebvre v. Commissioner, 830 F.2d 417, 420 (1st Cir. 1987). For additional examples of federal courts imposing sanctions on unrepresented parties under this rule, see Eric J.R. Nichols, Note, *Preserving Pro Se Representation in an Age of Rule 11 Sanctions*, 67 TEX. L. REV. 351 (1988)

31. Stelly v. Commissioner, 804 F.2d 868 (5th Cir. 1968)

32. *Id.*

33. Searcy v. Houston Lighting & Power Co., 907 F.2d 562, 565 (5th Cir. 1990) (affirming $109,335.30 sanction). *But see* Chitta v. Nueces County, 816 F.2d 676 (5th Cir. 1987) (per curiam) (refusing to impose sanctions).

34. Day v. Amoco Chems. Corp., 595 F. Supp. 1120, 1126 (S.D. Tex.) (awarding $10,000 in fees), *appeal dismissed*, 747 F.2d 1462 (5th Cir. 1984), *cert. denied*, 470 U.S. 1086 (1985). *In forma pauperis* is defined as "In the character or manner of a pauper." BLACK'S LAW DICTIONARY 712 (6th ed. 1990). Claims that they were poor will be met with the same response. McAfee v. 5th Circuit Judges, 884 F.2d 221, 223 (5th Cir. 1989), *cert. denied*, 110 S. Ct. 1141 (1990) (thirty-dollar sanction upheld).

35. Wideman v. McKay, 132 F.R.D. 62, 66 (D. Nev. 1990) (sanction for wholly groundless complaint).

36. Haugen v. Sutherlin, 804 F.2d 490 (8th Cir. 1986).

and pro se petitioners appear to have worn out their welcome at the appellate level. Courts currently impose sanctions without any prior warning[37] and the fact that a plaintiff proceeds pro se does not provide him an "unfettered license to wage an endless campaign of harassment" against his opponents.[38] The fact that a pro se party's error was quite possibly "[a] product of lack of legal sophistication" does not prevent the imposition of sanctions.[39]

One circuit states that "judges should adopt a posture of assisting pro se appellants whenever possible to ensure a just resolution on the merits."[40] Courts of appeal also have a duty to insure that pro se parties do not lose their vested right to an appellate hearing based on an ignorance of the procedural requirements.[41] The right to the appellate process and due process in general is an inherent one and courts must be cautious that when the pro se litigant is vested with these duties, he is not simultaneously stripped of his due process rights.[42]

This mandate, though, has its limits. Failure to file a timely notice of appeal will not be excused merely because of an appellant's pro se status.[43] The fact that a pro se appellant used business days rather than calendar days in calculating the time available for an appeal did not force one agency to bend the rules and view the filing as timely.[44] Errors have been occasionally forgiven, however, as where a pro se litigant filed a notice of appeal without the correct address but attempted preservation of his right to appeal by means of a letter to the district court,[45] and when an appellant filed her appeal with the wrong forum.[46] Errors are less fatal when they occur in brief preparation. The formal appellate brief requirements are not construed so strictly as to make a violation fatal to a pro se litigant's case.[47] At least one court has held that a pro se appellate brief filed by a plaintiff in a different action is admissible.[48]

What of the case, then, where the appellant files a notice of appeal and does not make any arguments of error? The duties of a represented

37. *See, e.g.*, Simmons v. Poppell, 837 F.2d 1243 (5th Cir. 1988) (implying that district court's finding of frivolousness provided ample warning).

38. Pfeifer v. Valukas, 117 F.R.D. 420, 423 (N.D. Ill. 1987). Lack of knowledge is no excuse. A pro se litigant may not argue ineffective assistance on appeal based on his limited resources for meaningful research. United States v. Smith, 907 F.2d 42, 45 (6th Cir.), *cert. denied*, — U.S. —, 111 S. Ct. 521 (1990).

39. Texas v. Gulf Water Benefaction Co., 679 F.2d 85, 87 (5th Cir. 1982)

40. Bryant v. United States Postal Serv., 837 F.2d 1097 (Fed. Cir. 1987) (table, text available in Westlaw).

41. *Balistreri*, 901 F.2d at 696.

42. For a further discussion of this issue, see Julie M. Bradlow, Comment, *Procedural Due Process Rights of Pro Se Civil Litigants*, 55 U. CHI. L. REV. 659 (1988).

43. United States v. Merrifield, 764 F.2d 436, 437 (5th Cir. 1985).

44. Gostomski v. Commodity Trading Corp., Comm. Fut. L. Rep. (CCH) ¶ 23,784 (C.F.T.C. 1987).

45. Myers v. Stephenson, 781 F.2d 1036, 1038-39 (4th Cir. 1986).

46. Reece v. Veteran's Admin., 862 F.2d 321 (Fed. Cir. 1988).

47. *Balistreri*, 901 F.2d at 696.

48. Kassel v. Gannet Co., Inc., 875 F.2d 935 (1st Cir. 1989). *But see* Hardy v. Johns-Manville Sales Corp., 851 F.2d 742 (5th Cir. 1988) (statements from appellate briefs in another action not admissible).

litigant on appeal as they govern the raising of arguments are clear. The appellant must raise issues in the brief and press these issues.[49] The resulting arguments must be distinct and specific in the opening brief.[50] These arguments must give the appellee an opportunity to address them.[51] Ultimately, any argument not raised in the brief to a court of appeals has not been preserved for appeal.[52] One exception to this is when a public interest is involved.[53] Another exists for the issue of ripeness, which need not be argued to have a court of appeals consider the issue on appeal.[54] Proceeding pro se does not seem to create a third exception as courts are unanimous in their rejection of any kind of a duty to manufacture arguments for the appellant, whether that appellant is represented[55] or appearing pro se.[56]

B. *Tenth Circuit Opinion:* Securities and Exch. Comm'n v. Thomas.[57]

1. Facts

Roger Houdek, a defendant and appellant in the case, was enjoined by the district court from future violations of specific antifraud and registration provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934.[58] Houdek appealed, claiming nonviolation of the Act.[59] Even though he was represented by counsel, he filed his brief pro se and entered the appellate process as a pro se litigant.[60] Houdek failed to provide a table of contents with page references, a table of cases and other authorities with page references, a statement of subject matter and appellate jurisdiction and a standard of review.[61] Most troublesome, though, was his failure to provide the court with any references to the voluminous record.[62]

2. Holding

The court found several violations of Federal Rule of Appellate Procedure 28 and the local 10th Circuit Rule 28.2.[63] The court recognized

49. Pearce v. Sullivan, 871 F.2d 61 (7th Cir. 1989).

50. Miller v. Fairchild Indus., Inc., 797 F.2d 727 (9th Cir. 1986), *appeal after remand,* 876 F.2d 718 (9th Cir. 1989), *opinion amended and superseded,* 885 F.2d 498 (9th Cir. 1989), *cert. denied,* 494 U.S. 1056 (1990).

51. Rivera v. Benefit Trust Life Ins. Co., 921 F.2d 692 (7th Cir. 1991).

52. Picco v. Global Marine Drilling Co., 900 F.2d 846 (5th Cir. 1990).

53. Continental Ins. Cos. v. Northeastern Pharmaceutical. & Chem. Co., 842 F.2d 977 (8th Cir.), *cert. denied* 488 U.S. 821 (1988).

54. Chemical Waste Mgmt. Inc. v. EPA, 869 F.2d 1526 (D.C. Cir. 1989).

55. Friedel v. City of Madison, 832 F.2d 965 (7th Cir. 1987).

56. National Commodity and Barter Ass'n v. Gibbs, 886 F.2d 1240, 1244 (10th Cir. 1989); Brinkmann v. Dallas County Deputy Sheriff Abner, 813 F.2d 744 (5th Cir. 1987).

57. 965 F.2d 825 (10th Cir. 1992).

58. *Id.* at 825-26. Houdek was the appellant in this case and was named as a defendant along with Thomas, who did not appeal.

59. *Id.* at 826

60. *Id.*

61. *Id.*

62. *Id.*

63. 10TH CIR. R. 28.2 states that "[W]ith respect to each issue raised on appeal, the party shall state where in the record the issue was raised and ruled upon.". F. R. APP. P.

its general lenience with pro se appellants but was unwilling to extend this to the immediate defendant's "total disregard" for the rules.[64] The court characterized the Appellant's argument as one that complains of district court wrongs without specifying the errors the court is now called upon to right[65] and then relies upon authority which holds that the court is not required to manufacture a party's argument when the party has not drawn attention to the lower court's errors.[66] The court declined to "sift through" the record and manufacture defendant's argument.[67]

C. *Analysis*

The Tenth Circuit recognized the court's policy of leniency towards those appellants acting pro se.[68] At the outset, however, it made clear the lack of forgiveness toward an attorney's total disregard for the rules[69] and was similarly not impressed by defendant's argument of error and refusal to point out the offending sections.

Looking to its prior decision in *National Commodity and Barter Ass'n. v. Gibbs*,[70] the court reiterated that it is "not required to manufacture a party's requirement on appeal when it has failed in its burden to draw our attention to the error below."[71] It should be noted that other circuit courts hold the same to be true, regardless of the appellant's representation status.[72]

The court reminded the appellant of his obligation to provide the court with the essential references to the record in order to carry his burden of proving the error.[73] This obligation is cited from its decision in *SilFlo, Inc., v. SHFC, Inc.*[74] and comports with other circuits' holdings.[75] At least one other court recognizes that this obligation is also owed to the Appellee in order to give that party an opportunity to address the arguments of error.[76] The *Thomas* court then ruled that it would not "sift through" the record in search of defendant's contentions of error.[77]

The court relied on Tenth Circuit caselaw, deferring to the trial

28 states that "[t]he brief of the appellant shall contain . . . appropriate references to the record."

64. *Thomas*, 965 F.2d at 826.

65. *Id.*

66. *Id.* (*citing* National Commodity & Barter Ass'n v. Gibbs, 886 F.2d 1240, 1244 (10th Cir. 1989)).

67. *Id.* at 827.

68. *Id.* at 825-26.

69. *Id.* at 826.

70. 886 F.2d 1240 (10th Cir. 1989).

71. *Thomas*, 965 F.2d at 826 (quoting *National Commodity*, 886 F.2d at 1244).

72. *See, e.g.*, Rivera v. Benefit Trust Life Ins. Co., 921 F.2d 692 (7th Cir. 1991); Pearce v. Sullivan, 871 F.2d 61 (7th Cir. 1989).

73. *Thomas*, 965 F.2d at 827.

74. 917 F.2d 1507, 1514 (10th Cir. 1990).

75. *See, e.g.*, *Pearce*, 871 F.2d at 61.

76. *Rivera*, 921 F.2d at 692.

77. *Thomas*, 965 F.2d at 827.

court's ruling.[78] The court also provided support for their deference by stating that even if they reviewed the brief, they "were of the firm opinion" that Defendant's arguments would be without merit.[79]

## II. HARSH SANCTIONS FOR NONCOMPLIANCE WITH DISCOVERY: *EHRENHAUS V. REYNOLDS*

### A. *Background*

Many articles have been published dealing with the abuses of discovery and court reactions to these abuses.[80] A court has several avenues available to them for dealing with the abuses.

#### 1. Protections Against Abuse

Rule 26(g) applies Rule 11 certification requirements to discovery requests, responses and objections. Rule 26(g) imposes an affirmative duty on counsel to engage in pretrial discovery in a responsible manner.[81] The fact that a discovery request, response, or objection is informal will not remove it from Rule 26(g)'s scope.[82] Sanctions under this Rule are *mandatory* when the request, response or rejection is improper or interposed for an improper purpose.[83] These sanctions can range from attorney's fees[84] to dismissal and default.[85] Rule 26(g) provides that "[t]he nature of the sanction is a matter of judicial discretion to be exercised in light of the particular circumstances."[86]

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78. *Pearce*, 871 F.2d at 78 (relying on United States v. Downen, 496 F.2d 314, 319 (10th Cir.), *cert. denied*, 419 U.S. 897 (1974); *SilFlo*, 917 F.2d at 1514).

79. *Thomas*, 965 F.2d at 827.

80. *See, e.g.*, Michael Forrester, Note, *Dismissals for Discovery Abuse - Toward a New Standard in the District of Columbia*, 36 CATH. U. L. REV. 761 (1987); Richard W. Engel, Jr., Note, *Rule 61.01: Discovery Sanctions in Missouri*, 47 J. MO. B. 275 (1991).

81. Chapman & Cole v. Itel Containers Int'l B.V., 116 F.R.D. 550, 557 (S.D. Tex. 1987). The rule mandates the signing of each request for discovery or response or objection therto constituting that the signer has "read the request, response, or objection, and that to the best of the signer's knowledge, information, and belief formed after areasonable inquiry it is: (1) consistent with these rules and warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; (2) not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation; and (3) not unreasonable or unduly burdensome or expensive."

82. *Cf.* Markel v. Scovill Mfg. Co., 657 F. Supp. 1102 (W.D. N.Y. 1987) (letter seeking recusal, effectively treated as motion, held subject to Rule 11).

83. FED. R. CIV. P. 26(g) advisory committee's note (1983) ("Because of the asserted reluctance to impose sanctions on attorneys who abuse the discovery rules . . . Rule 26(g) makes explicit the authority judges now have to impose appropriate sanctions and requires them to use it.").

84. Hopei Garments, Ltd. v. Oslo Trading Co., Inc., No. 87 Civ. 0932, 1988 WL 25139 (S.D.N.Y. March 8, 1988).

85. Perkinson v. Houlihan's/D.C., Inc., 108 F.R.D. 667, 677 (D.D.C. 1985), *aff'd in relevant part*, 821 F.2d 686, 689 (D.C. Cir. 1987).

86. FED. R. CIV. P. 26(g). Note, however, that this rule does not generally apply to discovery motions. FED. R. CIV. P. 11, 26(g), advisory committee's note (1983). Rule 11 is generally not applicable to discovery papers. Zaldivar v. City of Los Angeles, 780 F.2d 823, 829-30 (9th Cir. 1986). It does, however, apply to discovery motions. *See, e.g.*, Greenberg v. Hilton Int'l Co., 870 F.2d 926 (2d Cir. 1989). In addition, false discovery

Another option to curtail discovery abuse is 28 U.S.C. § 1927.[87] Where rules are not being technically violated, but the proceeding is conducted in bad faith so as to delay or increase costs, § 1927 sanctions will properly be levied.[88] One example involved an attorney who prolonged a non-technical deposition for more than eight full days by improper objections, instructing his client not to answer and by injecting substantive testimony on his client's behalf. Counsel was properly sanctioned under § 1927.[89]

A court may also invoke its inherent powers to curb abuse that is otherwise not punishable under the Federal Rules.[90] Application of a court's inherent power is strongly indicated when counsel destroys potentially discoverable documents, regardless of their specific responsiveness to outstanding discovery requests.[91] Dilatory discovery tactics are also grounds for inherent power sanctions.[92] Inherent powers which include the powers to request silence and decorum in the courtroom are to be used sparingly and not as a substitute for the express powers of the court.[93]

Rule 37 affords courts a great deal of power that should not be diluted by resorting to inherent powers.[94] Rule 37 has essentially the same goals as inherent powers invocation — general deterrence and just compensation for violations.[95] It authorizes the court to penalize four specified categories of misconduct: (1) non-compliance with a discovery order;[96] (2) failure to admit in response to a request for an admission;[97] (3) specified misconduct in connection with depositions, interrogatories and requests for inspection;[98] and (4) failure to participate in framing a Rule 37(f) discovery plan.[99] This Rule, like Rule 26(g), is aimed squarely at preventing discovery abuse and is applied equally to winner and loser.[100]

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responses that later cause other court documents to be false will be sanctionable under Rule 11. Murray v. Dominick Corp. of Can., Ltd., 117 F.R.D. 512, 515-16 (S.D.N.Y. 1987).

87. This statute provides, in pertinent part, that "[a]ny attorney . . . who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorney's fees reasonably incurred because of such conduct." 29 U.S.C. § 1927 (1988).

88. Yagman v. Baden, 796 F.2d 1165, 1187 (9th Cir. 1986).

89. Brignoli v. Balch, Hardy & Scheinman, Inc., 126 F.R.D. 462, 466 (S.D.N.Y. 1989).

90. Chambers v. NASCO, Inc., — U.S. —, 111 S. Ct. 2123 (1991). *See also*, Roadway Express, Inc., v. Piper, 447 U.S. 752 (1980) (sanctions for discovery abuse upheld under both Rule 37 and the court's inherent powers).

91. National Ass'n of Radiation Survivors v. Turnage, 115 F.R.D. 543, 554 (N.D. Cal. 1987).

92. Lipsig v. National Student Mktg. Corp., 663 F.2d 178, 181-82 (D.C. Cir. 1980).

93. Strandell v. Jackson County, 838 F.2d 884 (7th Cir. 1987).

94. Maurice Rosenberg, *Sanctions to Effectuate Pretrial Discovery*, 58 COLUM. L. REV. 480, 496-97 (1958).

95. *In re* Agent Orange Prod. Liab. Litig., 818 F.2d 210, 212 (2d Cir. 1987), *cert. denied*, 484 U.S. 1004 (1988).

96. FED. R. CIV. P. 37(b).

97. *Id.* at 37(c).

98. *Id.* at 37(d).

99. *Id.* at 37(g).

100. *See, e.g.*, Sheets v. Yamaha Motors Corp., 657 F. Supp. 319, 328 (E.D. La. 1987) ($25,000 sanctions imposed against defendant and in favor of plaintiff, whose claims were

The four categories of misconduct operate with certain conditions attached. Rule 37(b) sanctions may be imposed only for disobeying a valid discovery order.[101] One court took a very hard-line approach to discovery deadlines, holding that a hurricane was no excuse for failure to make discovery.[102] Many courts do not look for the deterrent effect and will accept a plausible excuse set forth by the party under sanction.[103] A party's unreasonable failure to admit the truth of any matter requested under Rule 36 gives rise to a remedy only applicable to the client, not counsel.[104]

Sanctions may be sought for three types of discovery abuse, even without a court order: (1) failure to appear at his or her properly noticed deposition; (2) failure to serve answers or objections to properly served interrogatories; and (3) failure to respond in writing to a properly served request for production or inspection.[105] Failure to appear is strictly construed and only causes sanctions to issue when a deponent "literally fails to show up for a deposition session."[106]

Another category sanctionable is a party's failure to serve answers or objections to interrogatories under Rule 33. The sanctions require a "total failure to respond."[107] A partial failure must be remedied with a motion to compel discovery under Rule 37(a).[108]

Rule 37(d) also specifies that a failure to respond to production or inspection request is sanctionable.[109] A response that denies a response is sanctionable,[110] as is a response containing misrepresentations denying the existence of requested materials.[111]

Failure to frame a discovery plan under Rule 37(f) may also be

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separately dismissed with prejudice), *aff'd in part and remanded in part*, 849 F.2d 179 (5th Cir. 1988).

101. Holcomb v. Allis-Chalmers Corp., 774 F.2d 398, 400-01 (10th Cir. 1985). The order in question does not need to be written, and may be oral. Professional Seminar Consultants, Inc. v. Sino Am. Tech. Exch. Council, Inc., 727 F.2d 1470, 1474 (9th Cir. 1984). Even an attorney's promise in open court to produce has been held to be the equivalent of an order. Charter House Ins. Brokers, Ltd. v. New Hampshire Ins. Co., 667 F.2d 600, 604 (7th Cir. 1981). An order, however, cannot otherwise be implied from the district judge's perceived intent. Salahuddin v. Harris, 782 F.2d 1127, 1131-32 (2d Cir. 1986).

102. Downer v. Aquamarine Operators, Inc., 701 S.W.2d 238, 42-43 (Tex. 1985), *cert. denied*, 476 U.S. 1159 (1986).

103. *See, e.g.*, Fjelstad v. American Honda Motor Co., 762 F.2d 1334 (9th Cir. 1985).

104. Apex Oil Co. v. Belcher Co. of New York, Inc., 855 F.2d 1009 (2d Cir. 1988).

105. FED. R. CIV. P. 37(d).

106. *Salahuddin*, 782 F.2d at 1131 (quoting S.E.C. v. Research Automation Corp., 521 F.2d 585, 588-89 (2d Cir. 1975)). In an exceptional situation, however, a bad faith refusal to answer a question at a deposition could be construed as a non-appearance. Plevy v. Scully, 89 F.R.D. 665, 666-67 (W.D.N.Y. 1981).

107. Laclede Gas Co. v. G.W. Warnecke Corp., 604 F.2d 561, 565 (8th Cir. 1979).

108. Fox v. Commissioner, 718 F.2d 251, 254 (7th Cir. 1983). The response to the discovery request must be a meaningful one and a simple letter stating that the party is "unable to respond" is sanctionable. Minnesota Mining and Mfg. Co. v. Eco Chem., Inc., 757 F.2d 1256 (Fed. Cir. 1985).

109. FED R. CIV. P. 37(d).

110. *Minnesota Mining*, 757 F.2d at 1260-61.

111. Fautek v. Montgomery Ward & Co., Inc., 96 F.R.D. 141 (N.D. Ill. 1982).

sanctionable,[112] even though these discovery plans do not appear frequently.[113] Once set out, a failure to participate in the plan fully is sanctionable.[114]

2. Sanctions Against Abuse

Federally prescribed rules exist in order to procure compliance with requests for discovery and to sanction, often harshly, those who fail to comply.[115] Once an action or failure to act has become sanctionable, the decision then is what sanction is applicable, if one is at all. This decision is entrusted to the trial court[116] and the discretion vested with the courts is broad,[117] yet restrained by the requirement that the sanction be "just"[118] and "specifically related to the particular claim or defense at issue in the discovery order."[119]

To determine the justness of sanctions, the appellate court will consider the trial judge's weighing of appropriate factors before imposing sanctions and whether the severity of the sanction is warranted by the conduct.[120] The Supreme Court provided guidance in holding that discovery sanctions are not to be imposed when the violation is due to a real inability to comply.[121] Other courts have made it clear that the inability may not be self-imposed.[122] The test for dismissal is not particularly harsh and only determines whether the district judge abused his discretion and whether the discovery abuse was in bad faith, deliberately intentional or willful.[123] Even the fact that a less strenuous sanction than dismissal could have been more appropriate will not make dismissal an abuse of the court's discretion.[124]

The types of sanctions provided for are numerous.[125] Fees and ex-

112. FED. R. CIV. P. 37(g).

113. *See* Union City Barge Line, Inc. v. Union Carbide Corp., 823 F.2d 129, 134 (5th Cir. 1987) (noting fewer than 50 reported cases of courts implementing 26(f) discovery plans).

114. Nemmers v. United States, 681 F. Supp. 567 (C.D. Ill. 1988).

115. FED. R. CIV. P. 26(g), 37. For a general discussion of the application of these rules, see GREGORY P. JOSEPH, Sanctions: The Federal Law of Litigation Abuse §§ 25(e)(3), 40(a) (1989 & Supp. 1991); Maurice Rosenberg, *supra* note 94 at 485-86.

116. Coca-Cola Bottling Co. of Shreveport, Inc. v. Coca-Cola Co., 110 F.R.D. 363, 367 (D. Del. 1986).

117. Fonseca v. Regan, 734 F.2d 944, 947 (2d Cir.), *cert. denied*, 469 U.S. 882 (1984).

118. Professional Seminar Consultants, Inc. v. Sino Am. Technology. Exch. Council, Inc., 727 F.2d 1470, 1474 (9th Cir. 1984).

119. *Id.*

120. *In re* Rubin, 769 F.2d 611, 615 (9th Cir. 1985).

121. National Hockey League v. Metropolitan Hockey Club, 427 U.S. 639, 640 (1976) (per curiam). For an example of strict enforcement of this rule, see Searock v. Stripling, 736 F.2d 650, 653-54 (11th Cir. 1984).

122. Pesaplastic, C.A. v. Cincinnati Milacron Co., 799 F.2d 1510, 1521-22 (11th Cir. 1986).

123. Boogaerts v. Bank of Bradley, 961 F.2d 765, 768 (8th Cir. 1992).

124. *Id.*

125. FED. R. CIV. P. 37. These sanctions may be: (1) an order specifying that designated facts be taken as established for purposes of the action; (2) an order precluding litigation of certain issues; (3) an order precluding the introduction of certain evidence; (4) an order striking out pleadings or part thereof; (5) an order staying further proceedings pending compliance with an order that has not been obeyed; (6) dismissal of the action in

penses, common sanctions, may be awarded against both clients[126] and attorneys[127]. Preclusion awards, those that bar a litigant from court, however, are carefully imposed by the courts.[128] They may either preclude a party from asserting their otherwise valid claim or defense,[129] or they may preclude a party from introducing a piece of evidence.[130] A court may also deem matters at issue admitted.[131] Another sanction available is that of contempt of court, which is a harsh measure and available only when a showing can be made that an order has been violated.[132] Contempt is often used by the courts as an alternative to entry of a default or dismissal.[133]

The most severe sanctions, and the ones of import here, are those of dismissal or default. These are draconian sanctions,[134] properly imposed only as last resort.[135] The Tenth Circuit holds that dismissal is a severe sanction applicable only in extreme circumstances and should be used as a weapon of last, rather than first, resort.[136] These sanctions are not appropriate when the violation "has been due to inability, and not to willfulness, bad faith or any fault of [the party]."[137] Courts construe this to require a showing of willfulness or bad faith before imposing the harsh sanctions of dismissal or default.[138] It must also be shown that less drastic alternatives will not achieve the necessary deterrent effect.[139] Dismissal or default are to be imposed only when there have been blatant, deliberate violations of orders or an established pattern of discovery abuse.[140] A single wilful violation or patterned noncompliance that does not cause serious prejudice is unlikely to sustain these

full or in part; (7) entry of a default judgment on some or all claims; (8) an order treating as contempt of court the failure to obey any discovery order except an order to submit to a physical or mental examination; (9) an award of reasonable expenses incurred in (i) making a successful, or opposing an unsuccessful motion to compel; (ii) proving at trial any matter which an opponent failed to admit in response to a request; (iii) moving for sanctions. *Id.*

126. J.D. Marshall Int'l, Inc. v. Redstart, Inc., 656 F. Supp. 830, 838 (N.D. Ill. 1987)

127. Home-Pack Transp., Inc. v. Donovan, 39 Fed. R. Serv. 2d (Callaghn) 1063, 1064-65 (D. Md. May 21, 1984) (magistrate's opinion).

128. Ferrara v. Balistreri & DeMaio, Inc., 105 F.R.D. 147, 151 (D. Mass. 1985).

129. *See, e.g.*, Libbi. v. Sears, Roebuck and Co., 107 F.R.D. 227, 229 (E.D. Pa. 1985) (party who refused to answer interrogatory concerning claim precluded from asserting that claim).

130. *See, e.g.*, Penk v. Oregon State Bd. of Higher Educ., 816 F.2d 458, 466 (9th Cir.), *cert. denied*, 484 U.S. 853 (1987) (court excluded statistical experts).

131. Rogers v. Chicago Park Dist., 89 F.R.D. 716, 719 (N.D. Ill. 1981).

132. Schlepper v. Ford Motor Co., 585 F.2d 1367, 1371 (8th Cir. 1978).

133. *See, e.g.*, Xaphes v. Merrill Lynch, Inc., 102 F.R.D. 545, 551-52 (D. Me. 1984) (assessing a $10,000 contempt fine).

134. *National Hockey League*, 427 U.S. at 643.

135. Poulis v. State Farm Fire & Cas. Co., 747 F.2d 863, 867-68, 870 (3d Cir. 1984).

136. Gocolay v. New Mexico Fed. Sav. & Loan Ass'n, 968 F.2d 1017, 1021 (10th Cir. 1992).

137. *National Hockey League*, 427 U.S. at 640.(quoting Societe Internationale v. Rogers, 357 U.S. 197, 212 (1958)).

138. *See, e.g.*, Ali v. Sims, 788 F.2d 954, 958 (3d Cir. 1986); Pressey v. Patterson, 898 F.2d 1018, 1023-24 (5th Cir. 1990) (requiring showing of bad faith).

139. *See, e.g.*, Batson v. Neal Spelce Assoc., Inc., 805 F.2d 546, 549-50 (5th Cir. 1986).

140. United States v. DiMucci, 110 F.R.D. 263, 266-67 (N.D. Ill. 1986).

drastic sanctions.[141]

In 1991, however, Judge Easterbrook of the Seventh Circuit convinced everyone that a new age of sanctioning had arrived. Sustaining a default judgment entered for tardy production of documents, he warned:

> For a long time courts were reluctant to enter default judgments, and appellate courts were reluctant to sustain those that were entered. Courts emphasized that litigants are entitled to decisions on the merits, and that default is a harsh sanction. Those times are gone . . . [D]istrict judges have become more aggressive in using their ultimate weapon to promote the efficient conduct of litigation. More power to them.[142]

A caution should be given here that the terms "dismissal" and "default" are not interchangeable. A plaintiff's failure to comply with discovery orders is properly sanctioned by dismissal of the suit and a defendant's failure is sanctioned by entry of a default judgment.[143]

A discovery decision or sanction propounded under any of the above powers is generally not appealable because it is not a final order within the meaning of 28 U.S.C. § 1291 and any party wishing to appeal such a decision must first defy the trial court's order and suffer contempt.[144] While discovery orders are generally not reviewable by mandamus, one court has issued a writ of mandamus to review a discovery order.[145] The collateral order doctrine[146] is normally not brought into play by a discovery order as these orders can generally be reviewed effectively on appeal from a final judgment.[147]

### B. *Tenth Circuit Opinion:* Ehrenhaus v. Reynolds[148]

#### 1. Facts

Appellant Reynolds filed a complaint in the United States District Court for the District of Colorado alleging securities fraud.[149] The appellees, as part of pre-trial discovery, deposed Ehrenhaus for three days during which he repeatedly attempted to invoke the attorney-client priv-

141. *See, e.g.*, Fjelstad v. American Honda Motor Co., 762 F.2d 1334 (9th Cir. 1985).

142. Metropolitan Life Ins. Co. v. Estate of Cammon, 929 F.2d 1220, 1224 (7th Cir. 1991).

143. Newman v. Metropolitan Pier & Exposition Auth., 962 F.2d 589, 591 (7th Cir. 1992) (Posner, J.).

144. *See, e.g.*, Sedlock v. Bic Corp., 926 F.2d 757-59 (8th Cir. 1991).

145. *In re* Von Bulow, 828 F.2d 94, 97 (2d Cir. 1987). *But see In re* Weisman, 835 F.2d 23, 27 (2d Cir. 1987) (refusing to issue writ of mandamus).

146. This doctrine permits an appeal from an interlocutory order, one that determines an issue completely separate from the merits of the action and which could not be given effective review on appeal from a final subsequent judgement. *See* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 545-47 (1949).

147. Coopers & Lybrand v. Livesay, 437 U.S. 463, 468 (1978). *But see* Corporation of Lloyd's v. Lloyd's, 831 F.2d 33, 34 (2d Cir. 1987) (applying collateral order doctrine to allow appeal from order denying discovery).

148. 965 F.2d 916 (10th Cir. 1992).

149. *Id.* at 918.

ilege.[150] Ehrenhaus then alleged disagreement with his counsel and counsel moved to withdraw.[151] This motion was never ruled upon.[152] The remainder of Ehrenhaus's deposition was rescheduled and prior to the deposition the district court ordered that the deposition take place in the federal courthouse so that the judge could contemporaneously rule on any attorney-client privilege assertions.[153] A warning was also given to Ehrenhaus through his counsel that if he failed to attend the deposition, a motion would be expected from appellees for dismissal.[154] Ehrenhaus moved unsuccessfully for a protective order, once again delaying discovery.[155] The ruling magistrate warned counsel for Ehrenhaus that he would be subjecting himself to sanctions if he did not attend.[156]

2. Holding

Ehrenhaus did not appear at the deposition and appellees moved to have the complaint dismissed with prejudice.[157] The motion was granted and survived a hearing on the motion.[158] An order was ultimately issued dismissing the complaint with prejudice, with specific findings that Ehrenhaus had willfully violated the court's discovery order.[159] The Tenth Circuit found that the deciding judge had given appropriate thought to the factors necessary to affirm the district court's dismissal. The court set the framework for the case by holding the dismissal of a case to be within the court's discretion if it concludes that dismissal alone would satisfy the interests of justice.[160]

3. Analysis

The trial court relied upon Rule 37(b)(2) as grounds for dismissal of an action if one party fails to obey a discovery order under Federal Rule of Civil Procedure 37(b)(2)(c).[161] Because the trial court had this permission, the court applied the abuse of discretion standard in reviewing the district court's ruling.[162] The court did, however, recognize that dismissal is an extreme sanction appropriate only where the offense has been willful.[163] Additionally, the necessity of using dismissal only as a last resort and the attendant defeat of a litigant's rights that goes with the dismissal were recognized.[164]

150. *Id.*
151. *Id.*
152. *Id.*
153. *Id.* at 918-919.
154. *Id.* at 919.
155. *Id.*
156. *Id.*
157. *Id.*
158. *Id.*
159. *Id.*
160. *Id.* at 918.
161. *Id.* at 920.
162. *Id.*
163. *Id.*
164. *Id.* (citing Meade v. Grubbs, 841 F.2d 1512, 1520 n.6 (10th Cir. 1988)). This

The court then applied caselaw restricting the trial judge's discretion in imposing a sanction to requiring imposition of one that is both "just" and "related to the particular claim at issue in order to provide discovery."[165]

The court established five factors to be considered in determining justness, relying on past Tenth Circuit established conditions.[166] The first factor is the degree of actual prejudice to the defendant.[167] The court deferred, as it did with all factors, to the trial court's finding of prejudice in the form of delay and increasing attorney's fees.[168] Another factor examined is the amount of interference with the judicial process that arose from the violation.[169] The court found Ehrenhaus's willful noncompliance a flouting of the court's authority and properly supporting sanctions under this factor.[170] The third factor is the culpability of the litigant.[171] The court found the explicit consideration given this factor by the trial judge noted the bad faith and willfulness of Ehrenhaus's conduct.[172] These three factors were previously applied by the Tenth Circuit in *Ocelot Oil Corp. v. Sparrow Industries*.[173]

A fourth factor was imported from *Willner v. University of Kansas*,[174] an earlier case decided by the Tenth Circuit. This factor was advance warning given that dismissal was a likely sanction for noncompliance with the order.[175] Here Ehrenhaus was put on notice that his failure to attend would likely lead to a motion for dismissal.[176] The court explicitly found this sufficient to satisfy the fourth factor.[177]

The final factor, again gleaned from *Ocelot*, is the efficacy of lesser sanctions.[178] This factor was not satisfied as persuasively as the court would prefer. In dicta, the court construed the district judge's comments, equating them with the judge's belief that less than the full range of sanctions was available to him.[179] Of some satisfaction to the Tenth Circuit, however, was the belief that the dismissing judge knew he had the opportunity to deny the motion.[180]

Though the satisfaction of these factors does not equal the passing of a threshold test, the court should attempt a recording of this evalua-

caution is alive and well in the Tenth Circuit. *See* Gocolay v. New Mexico Fed. Sav. & Loan Ass'n., 968 F.2d 1017 (10th Cir. 1992).

165. *Ehrenhaus*, 965 F.2d at 920-21 (citing Insurance Corp. of Ireland v. Campagnie des Bauxites de Guinee, 456 U.S. 694 (1982)).

166. *Ehrenhaus*, 965 F.2d at 921.

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.*

173. Ocelot Oil Corp. v. Sparrow Indus., 847 F.2d 1458 (10th Cir. 1988).

174. Willner v. University of Kan., 848 F.2d 1023, 1030 (10th Cir. 1988).

175. *Ehrenhaus*, 965 F.2d at 921.

176. *Id.*

177. *Id.*

178. *Id.* (applying *Ocelot*, 847 F.2d at 1465).

179. *Id.*

180. *Id.* at 921-22.

tion.[181] This test is thorough as relating to private interests in the litigation at hand. At least one circuit, the Ninth Circuit, has adopted a three-part test looking only to prejudice, warning and consideration of other sanctions.[182] The Tenth Circuit may wish in the future to look at these situations similar to the manner of the Ninth Circuit. The Ninth Circuit looks to public interest factors such as the expeditious resolution of litigation and the courts' need to manage the docket, but also to the public policy of favoring disposition of cases on their merits.[183]

## III. FORUM NON CONVENIENS DECISIONS, 1404(a) TRANSFERS AND THEIR APPEALABILITY: *SCHEIDT V. KLEIN*

### A. *Background*

A *forum non conveniens* claim is different from one of transfer. Under the doctrine of *forum non conveniens*, a court dismisses the case rather than transferring it, allowing the plaintiff to simply refile elsewhere. A motion may also be brought under 28 U.S.C. § 1404(a) to transfer.[184] "For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought."[185] Cases are no longer subject to dismissal under *forum non conveniens* if there is an alternative forum within the United States Federal Court System.

*Forum non conveniens* dismissals are harsher than § 1404(a) transfers.[186] For that reason, a greater degree of inconvenience is required for a *non conveniens* action to take place.[187] Consequently one district court in the Tenth Circuit has gone so far as to use *forum non conveniens* only in exceptional cases.[188] A statute of limitations may run before the plaintiff is able to refile and potentially stifling limitations exist as to where a plaintiff may refile under federal venue statutes because it may only be filed where the action was capable of originally being brought.[189]

The Supreme Court has listed the factors of both private and public interest that courts should consider when making *forum non conveniens* decisions.[190] The private interests delineated include the accessibility of evidence, ability to compel the attendance of witnesses, costs of trans-

181. *Id.* at 921.
182. Bank One of Cleveland, N.A. v. Abbe, 916 F.2d 1067 (6th Cir. 1990).
183. *See* Adriana Intern. Corp. v. Lewis & Co., 913 F.2d 1406 (9th Cir. 1990).
184. 28 U.S.C. § 1404(a) (1988).
185. *Id.* § 1404.
186. For a discussion of transfers under 1404(a), see Michael J. Waggoner, *Section 1404(a), Where It Might Have Been Brought: Brought By Whom?*, 1988 B.Y.U. L. REV. 67 (1988).
187. SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1154 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979).
188. Pioneer Prop., Inc. v. Martin, 557 F. Supp. 1354, 1361-62 (D. Kan. 1983).
189. For a discussion of federal venue possibilities, see David E. Seidelson, *Jurisdiction of Federal Courts Hearing Federal Cases: An Examination of the Propriety of the Limitations Imposed by Venue Restrictions*, 37 GEO. WASH L. REV. 82 (1968).
190. Gulf Oil Corp. v. Gilbert, 330 U.S. 501 (1947).

porting witnesses, a view of the site and the enforceability of a judgment.[191] Factors of public interest to be considered include court congestion, burden of jury duty, local interest in the litigation, avoidance of conflicts-of-law issues and unfamiliar laws.[192] In the Court's words, "unless the balance [of private factors] is strongly in favor of the defendant, the plaintiff's choice of forum should rarely be disturbed."[193] Courts are not to emphasize any one factor too heavily for fear of losing flexibility.[194]

These decisions often place a substantial burden on the party whose case has been dismissed or transferred. It is important to note that an order granting or denying a transfer under § 1404(a) is generally not in itself appealable, unless certified for interlocutory appeal under 28 U.S.C. § 1292(b) or a grant of a writ of mandamus.[195]

An appeal from the forum decision is not made without guidance. Federal courts may not attempt to determine what a state court would consider an appropriate forum[196] and may not, after dismissal, enjoin plaintiffs from filing an identical action in state court.[197] The doctrine of *forum non conveniens* is alive and well at the state court level where one state's courts may provide a more convenient site for litigation than that of the dismissing state.[198]

In 1981, the Supreme Court, in *Piper Aircraft v. Reyno*, found the doctrine of *forum non conveniens* applicable where the alternative forum was a foreign nation.[199] *Piper* provided guidance as to the standard to be used on appeal in reviewing the district court's decision, pronouncing it to be the clear abuse of discretion standard.[200] A court will grant substantial deference[201] where it is clear that the lower court considered all the relevant public and private factors as enunciated in the caselaw.[202] Some states have compiled statutory *forum non conveniens* fac-

191. *Id.* at 508.

192. *Id.* at 508-09.

193. *Id.* at 508.

194. Piper Aircraft v. Reyno, 454 U.S. 235, 249-50 (1981).

195. Cauwenberghe v. Biard, 486 U.S. 517 (1988). *But see* Kontoulas v. A.H. Robbins Co., 745 F.2d 312 (4th Cir. 1984) (holding order denying forum non conveniens dismissal appealable). For further discussion, see David E. Steinberg, *The Motion to Transfer and the Interests of Justice*, 66 NOTRE DAME L. REV. 443, 472-78 (1990).

196. Chick Kam Choo v. Exxon Corp., 486 U.S. 140, 148 (1988).

197. *Id.* at 140.

198. *See, e.g.*, McClain v. Illinois Cent. Gulf R.R. Co., 520 N.E.2d 368, 374 (Ill. 1988) (dismissing case under *forum non conveniens* doctrine where Tennessee was strongly favored as a more convenient forum).

199. *Piper*, 454 U.S. at 235. For discussion of an international plaintiff's experience, *see* Jacqueline Duval-Major, Note, *One-Way Ticket Home: The Federal Doctrine of Forum Non Conveniens and the International Plaintiff*, 77 CORNELL L. REV. 650 (1992).

200. *Piper*, 454 U.S. at 257.

201. For a discussion of Supreme Court decisions requiring virtually complete deference to lower court rulings on forum non conveniens, see Hon. Henry J. Friendly, *Indiscretion About Discretion*, 31 EMORY L.J. 747, 748-54 (1982).

202. *Piper*, 454 U.S. at 257. *Cf.* Allan R. Stein, *Forum Non Conveniens and the Redundancy of Court-Access Doctrine*, 133 U. PA. L. REV. 781, 832 (1985) (such decisions by the trial court are subject to only cursory appellate scrutiny).

tors removing discretion from the trial court.[203]

The standard for finding error in refusing to transfer an action under § 1404(a) is also a "clear abuse of discretion."[204] When a motion to transfer has been filed, the moving party bears the burden of establishing the inconvenience of the present forum.[205] The plaintiff, having chosen the forum, will be favored in this action.[206] A court will not merely shift inconvenience from one party to another,[207] for what is convenient for one party will often prove to be equally inconvenient for their adversary.

### B. *Tenth Circuit Opinion:* Scheidt v. Klein[208]

#### 1. Facts

This appeal stems from a case involving fraud and breach of contract claims against the appellant involving his representation of the plaintiff in Tax Court proceedings.[209] Defendant filed two motions, both denied, seeking a change in venue pursuant to 28 U.S.C. § 1404(a).[210] The defendant asserted that the majority of contemplated witnesses resided in Florida, the pertinent documentary evidence was located in Florida, the conduct occurred in Florida and was to be assessed under Florida substantive law. For all these reasons, the less expensive and more convenient forum for the litigation in his view was in Florida.[211]

#### 2. Holding

Defendant did not prove that (1) the witnesses were unwilling to come to trial in Oklahoma City, (2) deposition testimony would be unsatisfactory, or (3) that the use of compulsory process would be necessary.[212] Defendant also alleged that boxes of documents existed would have to be produced in support of the defense.[213] The court was unimpressed by these arguments and did not find error in the refusal to change venue.

### C. *Analysis*

The first contention of error was the district court's denial of the

203. *See, e.g.*, N.Y. Bus. Corp. Law § 1314 (McKinney 1986).
204. Metropolitan Paving Co. v. International Union of Operating Eng'rs, 439 F.2d 300, 305 (10th. Cir. 1971).
205. Chrysler Credit Corp. v. Country Chrysler, Inc. 928 F.2d 1509, 1515 (10th Cir. 1991).
206. William A. Smith Contracting Co. v. Travelers Indem. Co., 467 F.2d 662, 664 (10th Cir. 1972).
207. ROC, Inc. v. Progress Drillers, Inc., 481 F. Supp. 147, 152 (W.D. Ok. 1979).
208. 956 F.2d 963 (10th Cir. 1992).
209. *Id.* at 965.
210. *Id.* 28 U.S.C. § 1404(a) (1988) authorizes a district court to transfer a case "to any other district or division where it might have been brought."
211. *Scheidt*, 956 F.2d at 965.
212. *Id.* at 966. *See ROC*, 481 F. Supp. at 152.
213. *Scheidt*, 956 F.2d at 966.

appellant's motions for venue transfer under § 1404(a).[214] The court made it clear that three distinct and challenging hurdles must be cleared before dismissal would be affirmed.[215]

The first condition precedent to a finding of error in the refusal to transfer under § 1404(a) is that there be a clear abuse of discretion at the trial level.[216] This opinion appears to be widely-held and well-settled.[217] In the instant case, the Tenth Circuit found that the district court did not abuse its discretion.[218] Second, the movant bears the burden of establishing the inconvenience of the existing forum.[219] Finally, unless the balance strongly favors the party attempting transfer, the forum in which the plaintiff chose to file should not be changed.[220]

The court, without the benefit of an individual analysis of these factors pointed out that the collective weight of these factors favored the plaintiff in this case. The defendant's assertions for venue transfer have listed, apparently the same ones suggested previously by the Tenth Circuit in *Chrysler Credit Corp. v. Country Chrysler, Inc.*.[221] Defendant's first contention was that the majority of contemplated witnesses reside in Florida.[222] The court did not argue with this, but rather looked unsuccessfully for one of four factors to be present: an indication of quality of materiality of the testimony of the Florida witnesses, a showing that affected witnesses were unwilling to come to trial at the designated venue, a showing that deposition testimony would be unsatisfactory, or a showing of need for compulsory process.[223] They found that the defendant's "meager showing" provided none of these.[224]

Defendant next contended that the relative documentary evidence was located primarily in Florida.[225] He never explained or substantiated why these documents could not be reviewed in Florida and the documents of import shipped to Oklahoma, the original venue site.[226] The fact that he did not describe or identify these documents did not help his case.

Defendant's weakest contention for transfer was that Florida substantive law was to be applied in the case which might more easily be done if the case were heard in Florida.[227] The court summarily dis-

214. *Id.* at 965.
215. *Id.*
216. *Id.* (citing *Metropolitan*, 439 F.2d at 305).
217. *See* Christine Melady Morin, Note, Review and Appeal of Forum Non Conveniens and Venue Transfer Orders, 59 GEO. WASH. L. REV. 715 (1991).
218. *Scheidt*, 956 F.2d at 966.
219. *Id.* at 965 (citing Chrysler Credit Corp. v. Country Chrysler, Inc., 928 F.2d 1509, 1515 (10th Cir. 1991)).
220. *Id.* (citing William A. Smith Contracting Co. v. Traveler's Indem. Co., 467 F.2d 662, 664 (10th Cir. 1972)).
221. *Chrysler Credit Corp.*, 928 F.2d at 1516.
222. *Scheidt*, 956 F.2d at 965.
223. *Id.* at 966 (applying *ROC, Inc.*, 481 F. Supp. at 152).
224. *Id.*
225. *Id.* at 965.
226. *Id.* at 966.
227. *Id.* at 965.

missed this contention because of the simplicity of the legal issues involved in the common law fraud and breach of contract claims.[228] Defendant's final contention was that Florida would be the less expensive and more convenient forum.[229] The court believed that the change of venue to Florida would do no more than shift the inconvenience from the defendant to the plaintiff. The Tenth Circuit continued to hold a mere shift of inconvenience is impermissible[230] and that the district court did not abuse its discretion in denying the transfer motion. *Scheidt* is in agreement with the Supreme Court's policy of granting virtually complete deference to the trial court in this matter.[231]

## CONCLUSION

The cases surveyed illuminate the judiciary's increased awareness of the need to manage its docket effectively, while at the same time recognizing the need for litigation on the merits of cases. Improper tactics and frivolous motions are now being harshly dealt with by the Tenth Circuit.

As *Thomas* pointed out, courts are growing increasingly intolerant of the large number of frivolous pro se lawsuits filed and are rapidly stripping away the cloak of immunity that formerly existed protecting pro se litigants from their inadequacies.

Discovery is also coming under heightened scrutiny by the Tenth Circuit. Horror stories of discovery abuse are common and at least one major motion picture has been written about abusive and illegal discovery tactics in a product liability action.[232] Courts are now making it known to all parties involved that a dismissal or default judgment will be ordered more freely and earlier than it would have been several years ago. *Ehrenhaus* is just one of the first cases in the Tenth Circuit reflecting this.

The *Scheidt* case illustrated the courts' impatience with venue transfers. These no longer remain the viable delay-inducing, cost-increasing trial tactics they once were. The requirements are now being strictly adhered to and the defendant must have a compelling argument for overturning the plaintiff's choice of forum.

These three cases represent only a tiny fraction of the decisions touching on procedural issues decided this year by the Tenth Circuit. Yet, these cases, as a whole, indicate a judiciary possessing a heightened awareness of and reduced tolerance for improper conduct within its hallowed halls.

*Steven C. Tempelman*

228. *Id.* at 966.
229. *Id.* at 965.
230. *Id.* at 966 (citing *ROC, Inc.*, 481 F. Supp. at 152).
231. *See supra* text accompanying notes 203-04.
232. Class Action (Twentieth Century Fox 1991) (involving auto manufacturer's intentional obfuscation of critical discovery papers revealing knowledge of defects).

# COMMERCIAL LAW SURVEY

## I. OVERVIEW

During the survey period, the Tenth Circuit Court of Appeals addressed a variety of issues within the area of commercial law. Economic and political situations, both foreign and domestic, generated engaging issues for appellate review. At home, the mismanagement and failure of banks and savings and loans continued to produce a number of cases for Tenth Circuit review. Part I of this survey will analyze two of these cases: *United States v. Davis*[1] and *Federal Deposit Insurance Corporation v. Canfield*.[2]

In *Davis*, the court decided those who serve a federally insured institution, whether in an employment context or in some other position of trust, are "connected with" that institution for the purpose of conviction for misapplying federally insured funds under 18 U.S.C. § 657.[3] In *Canfield*, a case of first impression at the appellate level, the Tenth Circuit held that the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA)[4] provision allowing bank officers and directors to be held personally liable for "gross negligence" does not bar the Federal Deposit Insurance Corporation (FDIC) from seeking recovery against officers and directors under an ordinary negligence theory if applicable state law allows such actions.

Executive Orders issued in response to Iraq's invasion of Kuwait acted as a catalyst for a commercial law case involving letters of credit. Part II of this survey will analyze *Centrifugal Casting Machine Company v. American Bank & Trust*[5] in detail. In *Centrifugal*, the Tenth Circuit examined the complexities of letters of credit, reaching the conclusion that Iraq, as account party to a letter of credit, did not have a property interest in the contract down payment made to a beneficiary, Centrifugal Casting Machine Co. (CCM), even though CCM breached the underlying contract. As a result, the Executive Orders freezing Iraqi assets did not apply to the payment.[6]

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1. 953 F.2d 1482 (10th Cir.), *cert. denied*, 112 S. Ct. 2286 (1992).

2. 967 F.2d 443 (10th Cir.), *cert. dismissed*, 113 S. Ct. 516 (1992).

3. 18 U.S.C. § 657 (Supp. III 1991) (it is unlawful for a person who is "an officer, agent or employee of or connected in any capacity with" an insured institution to willfully misapply funds belonging to the institution).

4. In 1989, in response to the large number of bank and savings and loan failures, Congress enacted the FIRREA. FIRREA enables the FDIC to stand in the shoes of the failed bank and its stockholders to sue the officers and directors for mismanagement under state law. Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (codified in scattered sections of 12 U.S.C.). The issue in the *Canfield* case concerned 12 U.S.C. § 1821(k) (Supp. I 1989).

5. 966 F.2d 1348 (10th Cir. 1992).

6. *Id.* at 1354.

## II. BANKING CASES

### A. *Background*

The savings and loan (S&L) debacle represents one of the greatest scandals in American history. It is generally agreed that directors and officers mismanged the failing S&Ls.[7] Simple incompetence by inexperienced officers and managers combined with fraud resulted in poorly conceived loans and investments, loans to officers and directors, sweetheart loans to affiliated businesses, altered books, bribery and outright embezzlement.[8] Fraud, specifically, is implicated in approximately seventy percent of the failed institutions.[9] The issue before the court in *United States v. Davis*[10] was whether an individual, who was not an officer, director or an agent of a federally insured institution, could be prosecuted for misapplying funds under 18 U.S.C. § 657.[11] Although the Tenth Circuit had not addressed this issue, other circuits have given a broad interpretation of section 657.[12]

In addition to criminal activity, negligent management of financial institutions also contributed to the failure of banks and S&Ls. Although, historically, corporate directors and officers have enjoyed broad discretion in exercising their fiduciary duties,[13] courts increasingly examine

7. Carl Felsenfeld, *The Savings and Loan Crisis*, 59 FORDHAM L. REV. S7, S34 (1991).
8. *Id.*
9. *Id.*
10. 953 F.2d 1482 (10th Cir.), *cert. denied*, 112 S. Ct. 2286 (1992).
11. Davis also raised several other unrelated issues on appeal. For a full discussion of these issues see *Davis*, 953 F.2d at 1490-98.
12. In United States v. Prater, 805 F.2d 1441, 1446 (11th Cir. 1986), the president of a real estate subsidiary, solely owned by a savings and loan, was found to be "connected with" the savings and loan under section 657 where the president had the authority to initiate loans and the savings and loan board relied on him for accurate recommendation concerning loans. Those who serve a federally insured institution, whether in an employment context or in some other position of trust, the Eleventh Circuit found, were "connected with" that institution under section 657. *Id. See also* United States v. Payne, 750 F.2d 844, 855 (11th Cir. 1985).

A connection with a federally insured institution may result from control through stock ownership, or control through the power to extend credit. However, such direct control is not necessary to find that a defendant is connected with the institution. United States v. Rice, 645 F.2d 691, 693 (9th Cir.), *cert. denied*, 454 U.S. 862 (1981) (consultant retained by savings and loan to originate loans was "connected with" that institution, notwithstanding that he had not right to approve loans); United States v. Edick, 432 F.2d 350, 352 (4th Cir. 1970) (employee of bank service corporation was connected with the bank). In United States v. Garrett, 396 F.2d 489 (5th Cir.), *cert. denied*, 393 U.S. 952 (1968), controlling stockholders of a bank were charged with misapplication of national bank funds in connection with the purchase of mortgages by the bank. The mortgage sellers paid large commissions to a nonbank corporation owned by the defendants who then distributed the money among themselves. *Id.* at 490. The defendants argued that since they were not officers, directors, agents or employees of the bank, they were outside the reach of the statute. *Id.* The Fifth Circuit disagreed. After examining the connection between the defendants and the bank, the court found that the defendants and their nominees obtained control of the bank by acquiring the majority of its stock. *Id.* at 491. As controlling stockholders, the defendants had a fiduciary duty to both the bank and the minority shareholders. *Id.* The Fifth Circuit concluded the "fact of ownership . . . together with the activity . . . in furtherance of control demonstrates a connection with the bank within the meaning of the statute." *Id.*

13. James J. Hanks, Jr., *Evaluating Recent State Legislation on Director and Officer Liability Limitation and Indemnification*, 43 BUS. LAW. 1207 (1988). "Courts interfere seldom to con-

the propriety of corporate decisionmaking.

Financially distraught companies are frequent sources of litigation challenging the actions of corporate directors and officers.[14] With the onslaught of lawsuits, costs of director and officer (D&O) liability insurance increased dramatically.[15] As a result, many directors and officers chose to resign rather than expose themselves to personal liability due to inadequate D&O coverage.[16] Many states quickly responded to these developments by enacting legislation limiting director and officer personal liability.[17] The states limited liability by imposing lower liability standards, some requiring proof of conduct exceeding gross negligence.[18]

Utah, however, takes an opposite position. Under Utah law, an officer or director can be liable for ordinary negligence.[19] The issue before the court in *Canfield* was whether section 1821(k) of FIRREA established a national liability standard of gross negligence for actions brought by the FDIC, and thereby preempted the Utah law that permitted such actions under a simple negligence standard.[20]

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trol such discretion *intra vires* the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment." *Id.* (quoting United Copper Sec. Co. v. Amalgamated Copper Co., 244 U.S. 261, 263-64 (1917)). Thereafter, the business judgment rule was routinely invoked to validate directors and officers decisions and to insulate them from personal liability. *Id.*

14. *See, e.g.*, Fox v. Chase Manhattan Corp., No. 91 JUV-0831, 1986 WL 637 (Del. Ch. Jan. 2, 1986) (Delaware Chancery Court approved a $32.5 million settlement of suit against Chase Manhattan Corp. and six of its officers arising out of the collapse of Drysdale Government Securities); National Union Fire Ins. Co. v. SeaFirst Corp., 891 F.2d 762 (9th Cir. 1989) (bank holding company and five of its officers agreed to entry of judgment for $10 million).

15. Over the course of one year, D&O insurance increased an astonishing 360%. *Insuring Directors*, WALL ST. J., Mar. 21, 1986, at 31.

16. Hanks, *supra* note 13, at 1209.

17. *See, e.g.*, IND. CODE § 23-1-35-1(e) (1989)(willful misconduct or recklessness); WIS. STAT. § 180.0828(1) (1992)(willful misconduct).

18. *See* sources cited *supra* note 17. *See generally* Hanks, *supra* note 13; Douglas M. Branson, *Assault on Another Citadel: Attempts to Curtail the Fiduciary Standard of Loyalty Applicable to Corporate Directors*, 3 FORDHAM L. REV. 375 (1988).

19. UTAH CODE ANN. § 16-10a-840 (Supp. 1992).

20. 12 U.S.C. § 1821(k) provides:

> A director or officer of an insured depository institution may be held personally liable for monetary damages in any civilaction by, on behalf of, or at the requestor direction of the Corporation, which action is prosecuted wholly or partially for the benefit of the Corporation-
>
> (1) acting as conservator or receiver of such institution,
>
> (2) acting based upon a suit, claim, orcause of action purchased for, assigned by, or otherwise conveyed by such receiver or conservator, or
>
> (3) acting based upon a suit, claim, or causeof action based upon a suit, claim, orcause of action purchased from, assigned by, or otherwise conveyed in whole or inpart by an insured depository institution or its affiliate in connection withassistance provided under section 1823 of this title, for gross negligence, including similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined underapplicable State law. Nothing in this paragraph shall impair or affect any right of the Corporation under other applicable law.

12 U.S.C. § 1821(k) (Supp. I 1989).

B. *United States v. Davis*[21]

1. Facts

*United States v. Davis* involved the theft of federally insured deposits through a series of complex transactions containing elements of deception, collusion, conflicts of interest and self-dealing.[22] Defendants Don C. Davis and Daniel M. Burke misapplied or diverted millions of dollars at the expense of several banks and savings and loans, and ultimately the United States Treasury.[23]

Davis and Burke exercised control over the Guarantee Federal Bank (GFB) as part of a group that controlled a majority block of stock.[24] Burke was a director of GFB, and although Davis was not a board member, he frequently gave financial advice to the board and attended board meetings.[25] Davis and Burke influenced GFB president's decision to purchase securities from bank holding companies in which Davis and Burke had interests.[26] In reality, through a series of transactions, the money was diverted to Davis and Burke. The United States District Court for the District of Wyoming[27] convicted Davis and Burke of misapplying federally insured deposits under 18 U.S.C. § 657.[28] On appeal, Davis argued his conviction was invalid because the prosecution did not meet its burden and establish that Davis was an officer, agent, or employee of a federally insured institution.[29]

2. Tenth Circuit Decision

The Tenth Circuit was unswayed by Davis' argument that only "officers, agents, or employees" who are "connected in any capacity with" an insured institution may be found liable under section 657.[30] The court disagreed with Davis' construction of the statute, finding it too

21. 953 F.2d 1482 (10th Cir.), *cert. denied*, 112 S. Ct. 2286 (1992).

22. *Id.* at 1486.

23. In addition to being charged with misapplying federally insured funds under 18 U.S.C. § 657, Davis and Burke were also charged with violating 18 U.S.C. § 371 (conspiracy to commit offenses against, and to defraud the United States); 18 U.S.C. § 1343 (wire fraud); 18 U.S.C. § 1006 (making false entries in bank books and records or unlawful receipt of benefits). Davis was also charged with 18 U.S.C. § 1014 (overvaluing security and making false statements). *Davis*, 953 F.2d at 1486.

24. *Davis*, 952 F.2d at 1487.

25. *Id.*

26. *Id.*

27. United States v. Davis Nos. 89-8051, 89-8052, 90-8057, 90-8058 (D. Wyo. 1990) (on file at Denv. U.L. Rev. offices).

28. Davis was convicted on fourteen counts including one count of conspiracy, five counts of wire fraud, four counts of misapplying federally insured funds, two counts of aiding an abetting false entries, one count of aiding and abetting in the unlawful receipt of benefits, and one count of overvaluing securities. The jury convicted Burke on eleven counts including one count of conspiracy, three counts of wire fraud, four counts of misapplying federally insured funds, two counts of make false entries and one count of unlawfully receiving benefits. *Davis*, 952 F.2d at 1486. Burke died soon after sentencing and Davis petitioned the circuit for review. *Id.* at 1487.

29. *Id.* at 1488.

30. 18 U.S.C. § 657 (Supp. III 1991).

narrow.[31] To read the statute as Davis advocated would require the court to ignore the Act's language: "*[w]hoever*, being an officer, agent or employee of or connected in any capacity with."[32] The fact that Davis had not formally been designated an agent of GFB did not preclude the trier of fact from finding an agency relationship based upon conduct.[33] Furthermore, the prosecution did not have to show that Davis was an agent, but merely that he was "connected in any capacity with" an insured financial institution.[34]

The court explained that the "connected in any capacity with" language should be broadly interpreted in accordance with the congressional resolve to protect federally insured institutions against fraud.[35] The court also pointed out that each case should be evaluated on its own facts.[36] Based upon the control Davis exercised over GFB and his extensive participation in the affairs of GFB, the Tenth Circuit concluded that Davis was "connected" with the institution within the meaning of section 657.[37]

### C. *Federal Deposit Ins. Corp. v. Canfield*[38]

#### 1. Facts

The Federal Deposit Insurance Corp., brought suit against the former directors and officers of Tracy Collins Bank and Trust, a Utah financial institution, seeking damages of $7 million for imprudent loans made or approved by the defendants, and damages for waste of bank assets and mismanagement.[39] The defendant officers and directors argued that section 1821(k) preempts state law and bars the FDIC from seeking damages from officers and directors for any conduct less than gross negligence.[40] The FDIC asserted that section 1821(k) preserved the ability of the FDIC to sue, when authorized by state law, for damages against officers and directors for ordinary negligence.[41] The FDIC maintained its interpretation was consistent with the objectives of FIRREA. The district court examined the language of section 1821(k), its legislative history and the public policy arguments advanced by both parties, and reached an opposite conclusion, holding that section 1821(k) created a national standard of gross negligence, and thereby preempted conflict-

31. *Id.* at 1489.
32. *Id.* (quoting 18 U.S.C. § 657).
33. *Davis*, 953 F.2d at 1488.
34. *Id.*
35. *Id.* at 1489. *Cf. United States v. Ratchford*, 942 F.2d 702, 705 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 1185 (1992). The Tenth Circuit held that a property manager who diverted funds from an apartment complex owned by two savings and loan associations was sufficiently connected to federally insured institutions to support conviction under § 657.
36. *Davis*, 953 F.2d at 1489.
37. *Id.* at 1989-90.
38. 967 F.2d 443 (10th Cir.) *cert. dismissed*, 113 S. Ct. 516 (1992).
39. *Canfield*, 763 F. Supp. at 534. *See also supra* note 4.
40. *Canfield*, 763 F. Supp. at 534. Under Utah law, the directors and officer would be personally liable for money damage for simple negligence.
41. *Id.*

ing state law.[42]

2. Tenth Circuit Decision

On appeal, the Tenth Circuit mirrored the lower court's analysis of section 1821(k). However, the conclusions were markedly different. Following the district court's analysis, the appellate court began with the plain language of the statute.[43]

According to the Tenth Circuit, the language used in section 1821(k) to describe the potential liability of officers and directors belied the creation of an exclusive national liability standard.[44] The first sentence of the statute states that "a director or officer *may* be held personally liable for monetary damages . . . for gross negligence."[45] The court focused its attention on the word "may", stating that " 'may' is a permissive term, and it does not imply a limitation on the standards of officer and director liability."[46] To affirm the lower court's construction of section 1821(k), the appellate court concluded it would have to construe the first sentence as saying that "an officer or director *may only* be held personally liable for gross negligence."[47] This would require the insertion of a word into the statute, which the court refused to do.[48] Furthermore, the Tenth Circuit found the last sentence of the statute consistent with this interpretation.[49] "Other applicable law", in the last sentence, means all "other applicable law"—state, federal or any other.[50] Any other law providing that an officer or director may be held liable for simple negligence survives, such a law being "other applicable law."[51] Construing the statute to bar application of such "other law" would impair the FDIC's enforcement rights.[52]

In further support of this conclusion, the court relied on the general rule of statutory construction that "the statute should be read as a whole."[53] The court observed that "[n]owhere does the statute announce its intention to create a national standard of liability."[54] In fact, the statute's reliance on state law to define gross negligence contra-

42. *Id.* at 540.

43. Id. at 445. (the Court began with the plain language of the law) (quoting United States v. Morgan, 922 F.2d 1495, 1496 (10th Cir.), *cert. denied*, 111 S.Ct. 2803 (1991)).

44. *Canfield*, 967 F.2d at 446.

45. *Id.* at 446 (quoting 12 U.S.C. § 1821(k)).

46. *Id.* (citing Rose v. Rose, 481 U.S. 619, 626-27 (1987)) (the Court refused to read "may" as establishing anything other than discretionary power).

47. *Canfield*, 967 F.2d at 446.

48. *Id. See* Resolution Trust Corp. v. Lightfoot, 938 F.2d 65, 66-67 (7th Cir. 1991) ("may" does not mean "may only").

49. *Canfield*, 967 F.2d at 446.

50. *Id. See also* Small v. Britton, 500 F.2d 299, 301 (10th Cir. 1974)(reliance must be placed on unambiguous statutes "evident meaning"); Patterson v. Shumate, 112 S. Ct. 2242 (1992)(the Court read "applicable bankruptcy law" in 11 U.S.C. § 541(c)(2) to include both state and federal law).

51. *Canfield*, 967 F.2d at 446.

52. *Id.*

53. *Id.* (citing 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 46.05 (5th ed. 1992)).

54. *Canfield*, 967 F.2d at 447.

dicted the proposition that FIRREA establishes a national standard because state law definitions of gross negligence vary.[55] In contrast, other sections of FIRREA specifically mention the applicability of state law or federal law.[56]

Next, the court reviewed the legislative history behind the statute and found it consistent with its interpretation of the plain meaning of the statute. Specifically, the court followed the senate's lead finding that section 1821 "does not prevent the FDIC from pursuing claims under State law or other applicable Federal law, if such law permits the officers or directors of a financial institution to be sued for violating a lower standard of care, such as simple negligence."[57]

Finally, the Tenth Circuit addressed the public policy arguments raised by the defendants and concluded that these arguments were raised in the wrong forum.[58] By inserting the "other applicable law" verbiage, Congress intended to let the individual states decide the propriety of a simple negligence standard.[59] By doing so, Congress allowed states to consider the implications of problems such as the difficulty of obtaining D&O insurance and its effect on attracting competent and aggressive business leaders.[60] In this case, the court's only consideration was whether the statute prohibited the FDIC from pursuing the Utah action against these defendants; not the merits of a simple negligence standard.[61]

3. Dissenting Opinions

Judges Brorby and Moore file separate dissenting opinions.[62] Brorby's dissent attacked the majority's analysis of legislative intent stating that "[f]ew are so naive as to believe there exists but a single correct interpretation of any given statute."[63] While Brorby believed the majority opinion supportable, he found the better interpretation of section

55. *Id.* "[T]here is . . . no generally accepted meaning [of gross negligence]." *Id.* (W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 34, at 212 (5th ed. 1984).

56. Parts of § 1821 of the statute refer specifically to the other bodies of law it touches. *See, e.g.*, 12 U.S.C. § 1821(c)(3)(B) ("powers imposed by State law"); § 1821(c)(4) ("notwithstanding any other provision of Federal law, the law of any State"). Similarly, when the statute refers to itself, it does so with specificity. *See, e.g.*, § 1821(d)(2)(I) (FDIC may "take any action authorized by this chapter"); § 1821(e)(3)(C)(ii) ("except as otherwise specifically provided in this section"). Additionally, when the statute refers to the whole universe of other laws, it uses the same language as that in section 1821(k). *See also* § 1821(e)(12)(B) ("No provision of this paragraph may be construed as impairing or affecting any right . . . under other applicable law.").

57. *Canfield*, 967 F.2d at 448-49 n.6 (quoting 135 CONG. REC. S6912 (daily ed. June 19, 1989)).

58. *Id.* at 448.

59. *Id.*

60. *Id.* at 448-50. *See supra* note 17 and accompanying text.

61. *Canfield*, 967 F.2d at 448.

62. *Id.* at 449 (Brorby, J., dissenting).

63. *Id.* at 449 n.1. For nearly every canon of statutory construction, there exists an opposing canon which supports a contrary interpretation. *Id.* (citing Karl N. Llewellyn, *Remarks on the Theory of Appellate Decisions and the Rules or Canons About How Statutes are to be Construed*, 3 VAND. L. REV. 395 (1950)).

1821(k) in the district court's opinion which not only gave effect to the plain meaning of the statute, but also served Congress' longstanding goal to achieve uniform administration of federal financial institutions.[64] This interpretation heeds important public policy concerns underlying FIRREA.[65] Therefore, Brorby concluded that section 1821(k) defined "an exclusive, uniform federal threshold of gross negligence for the personal liability of bank directors and officers named in civil damage suits brought by the FDIC."[66]

D. *Analysis of Banking Cases*

The results in *Canfield* and *Davis* are not surprising. The Tenth Circuit decisions in the banking cases show very broad construction and deference to the statutes relating to the mismanagement and failure of banks and savings and loans. It is very clear that the court responded to the public outrage over the saving and loan bailout and its astronomical cost to taxpayers. Although it is too late to correct these past abuses, the court sent a strong message that this type of conduct will not go unchallenged or unpunished. Although the Tenth Circuit opinions in *Canfield* and *Davis* clearly reflect public sentiment, the decisions are well reasoned and supported by a thoughtful analysis of precedent and statutory interpretation doctrine.

The precedential decision in *Canfield* effects officers and directors of financial institutions, placing them on notice that their managerial decisions require considerable deliberation. Challenges to perceived negligent conduct in the management of financial institutions will continue with the courts increasingly willing to scrutinize corporate decisionmaking and award damages when appropriate. It will be interesting to observe the *Canfield* decision's impact on bank and S&L ability to attract competent management. We may see greater hesitation by officers and directors to accept positions in an industry where they are held to a higher decision making standard.

Unlike the *Canfield* opinion, where the Tenth Circuit engaged in independent analysis, the *Davis* decision relied heavily on cases in other circuits to conclude that Davis was "connected" with GFB for the purpose of section 657.[67] In *Davis*, the Tenth Circuit Court primarily relied on a substantially analogous case decided by the Fifth Circuit in *Garrett v. United States*.[68]

The *Davis* opinion, like the *Canfield* opinion, promotes careful scrutiny of bank officials' conduct. *Davis* gives a very broad interpretation of the class of individuals that are "connected with" a federally insured in-

64. *Id.*

65. *Id.* at 451.

66. *Id.* at 452. Judge Moore concurred with Judge Brorby's dissent but wrote separately to emphasize his belief that if Congress had intended to establish a standard of simple negligence for officer and director liability, it would have stated it unequivocally. To conclude otherwise "defies my form of fundamental logic." *Id.* (Moore, J., dissenting).

67. See *supra* note 12.

68. 396 F.2d 489 (5th Cir.), *cert. denied*, 393 U.S. 952 (1968). *See supra* note 12.

stitution for the purpose of criminal responsibility under 18 U.S.C. § 657. Not only will officers, directors and agents of a financial institution be held accountable for misapplying federally insured funds, but those individuals who are less formally and more remotely associated with the federally insured institution are now firmly within the grasp of this statute.

## III. LETTERS OF CREDIT

### A. *Background*

The letter of credit was developed as a payment mechanism to alleviate the tension that exists between sellers, who do not want to give up possession of goods before payment is made, and buyers, who want to have control of goods before payment is tendered. In general, the letter of credit transaction is a three party arrangement. An "issuer" (generally a bank) agrees to pay conforming drafts presented under the letter of credit; a bank customer or "account party" orders the letter of credit and dictates its terms; and a "beneficiary" to whom the letter of credit is issued along with the corresponding right to collect monies under the letter of credit by presenting drafts and making proper demand on the issuer.[69] The letter of credit is normally irrevocable[70] and contains an expiration date.

This arrangement results in the beneficiary's assurance of payment because the irrevocable obligation of the account party's bank runs solely to the beneficiary. This obligation requires performance even when a dispute arises between the account party and the beneficiary and the account party requests the issuing bank not to pay.[71] Furthermore, the bank must pay even if the account party is insolvent, cannot, or refuses to reimburse the bank for payment to the beneficiary.[72]

Today two broad categories of letters of credit exist; the "commercial letter of credit" used most commonly in international business transactions to reinforce the mode of payment[73] and the "standby letter of credit" used as a backup against default on obligations.[74] In the past decade, with bank failure, customer failure, beneficiary failure, and the development of standby letters of credit, a considerable volume of litigation over these instruments developed.[75] The defensive positions taken by attorneys, and the poor draftsmanship of letters of credit reflected in these cases illustrate the existing misunderstandings regarding the legal nature of the letters of credit.[76] It is clear that Article 5 of the Uniform

69. Arbest Const. Co. v. First Nat'l Bank & Trust Co., 777 F.2d 581, 583 (10th Cir. 1985).
70. UNIFORM COMMERCIAL CODE § 5-103(1)(a)(B)(1991).
71. *Id.* §§ 5-114(1) to -114(2).
72. *Id.* § 5-114(3).
73. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 19-1, at 806 (3d ed. 1988).
74. *Id.* § 19-1, at 809.
75. *Id.* § 19-2, at 812.
76. *Id.*

Commercial Code, pertaining to letters of credit, is no longer equal to its task.[77] In the case that follows, under the veil of executive orders freezing Iraqi assets in the United States, the Tenth Circuit set out to determine if Iraq, as an account party to a letter of credit, had a property interest in a payment made to a beneficiary who breached the underlying contract.

### B. *Centrifugal Casting Machine Co. v. American Bank & Trust Co.*[78]

#### 1. Facts

Iraq was an account party to a letter of credit and a beneficiary of a standby letter of credit.[79] These letters were issued as payment mechanisms in connection with a contract between Centrifugal Casting Machine (CCM), an American company, and State Machinery Trading Company (SMTC), an agency of the Iraqi government.[80]

The parties agreed on an irrevocable letter of credit as the form of payment between SMTC to CCM, for the benefit of CCM in the contact amount.[81] The Central Bank of Iraq (CBI) issued the letter of credit and entitled CCM to draw ten percent of the contract amount as a downpayment ($2.7 million).[82] Additionally, the parties agreed to the issuance of a standby letter of credit in the amount of ten percent of the contract amount ($2.7 million) made by CCM for the benefit of SMTC.[83] This standby letter of credit was available to repay SMTC the amount of the downpayment upon receipt of proof that CCM had not performed under the contract.[84] SMTC attempted to draw on the standby letter of credit, however, the attempt was not accompanied by the requisite proof of CCM's nonperformance. Consequently the drawdown was not honored before the expiration date set out in the letter.[85]

The United States intervened in suits involving parties to the letter of credit and asserted that Iraq had a property interest in $2.7 million deposited by CCM with ABT as security for the standby letter. The United States claimed the bank account containing the $2.7 million was subject to Executive Orders freezing assets of the Iraqi government.[86]

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77. *See* JOHN M. STOCKTON & FREDERICK H. MILLER, SALES AND LEASES OF GOODS IN A NUTSHELL 117 (3d ed. 1992); *See also* Task Force Report, *An Examination of U.C.C. Article 5 (Letters of Credit)*, 45 BUS. LAW. 1521 (1990).

78. 966 F.2d 1348 (10th Cir. 1992).

79. *Id.* at 1349.

80. *Id.*

81. *Id.*

82. *Id.* at 1350.

83. *Id.*

84. This standby letter of credit was issued by Banca Nazionale del Lavoro (BNL) to American Bank of Tulsa (ABT), CCM's bank, as the account party, and made payable to Rafidain Bank, which in turn issued a $2.7 million guarantee to SMTC. *Id.* CCM deposited its downpayment under the letter of credit with ABT as security to protect ABT against any obligation it might incur on the standby letter of credit. *Id.*

85. *Id.*

86. Following Iraq's invasion of Kuwait in August of 1992, President Bush issued two Executive Orders blocking any transfer of property in which Iraq held an interest. *See*

The district court found no valid draw had been made on the standby letter of credit, the letter had expired by its own terms, and that CCM, ABT and BNL had no liability under the standby letter of credit.[87] In doing so, the court rejected the claim of the United States.

2. Tenth Circuit Decision

On appeal, the United States argued that the freeze of Iraqi assets furthered the national policy adopted to punish Iraq by preventing economic benefits from transactions with American citizens and companies.[88] Furthermore, the freeze preserved Iraqi assets for use as bargaining chips in negotiations and sources for compensation for American claims against Iraq.[89] Although the court found the policy arguments compelling, and agreed that Iraqi property interests should be construed in the broadest sense, the court remained unpersuaded that the facts in this case gave rise to a property interest in Iraq when it would not otherwise be cognizable under governing legal principles.[90]

The asset in issue, according to the reasoning of the United States, was the down payment Iraq made on the contract with CCM. Since CCM did not perform on the contract, it was argued that Iraq had an interest in this downpayment based on breach of contract.[91] However, the court disagreed with this reasoning finding it contrary to the principles governing the financial mechanisms chosen by the parties to guarantee payment under the contract.[92]

The Tenth Circuit began its analysis by examining the relationships of the parties under the standby letter of credit.[93] A letter of credit thus involves three legally distinct relationships: "between the issuer and the account party, the issuer and the beneficiary, and the account party and the beneficiary (this last relationship being the underlying business deal

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Exec. Order No. 12,722, 55 Fed. Reg. 31,803 (1990); Exec. Order No. 12,724, 55 Fed. Reg. 33,089 (1990). These orders were implemented by regulations promulgated by the Secretary of the Treasury, through the Office of Foreign Assets Control. See 31 C.F.R. §§ 575.201-.806 (1991). Under these regulations, "no property or interests in property of the Government of Iraq that are in the United States . . . may be transferred, paid, exported, withdrawn or otherwise dealt in." *Id.* § 575.201(a).

87. Centrifugal Casting Machine Co., Inc., v. American Bank & Trust Co., and Iraq, No. 91-5150 (N.D. Okla. 1991) (on file at Denv. U.L. Rev. offices).

88. *Centrifugal*, 966 F.2d at 1350.

89. *Id.* at 1350-51.

90. *Id.* at 1351.

91. *Id.*

92. *Id.*

93. Because the term "letter of credit" was not defined in either the Executive Orders or the implementing regulations, the court used the meaning ordinarily used by the courts and parties dealing with this kind of arrangement. *See* Propper v. Clark, 337 U.S. 472, 480 (1949).

> [A] letter of credit involves three parties: (1) an issuer (generally a bank) who agrees to pay conforming drafts presented under the letter of credit; (2) a bank customer or 'account party' who orders the letter of credit and dictates its terms; and (3) a beneficiary to who the letter of credit is issued, who can collect monies under the letter of credit by presenting drafts and making proper demand on the issuer.

*Centrifugal*, 966 F.2d at 1351 (quoting Arbest Constr. Co. v. First Nat'l Bank & Trust Co., 777 F.2d 581, 583 (10th Cir. 1985)).

giving rise to the issuance of the letter of credit)."[94] In this case, CBI was the issuer, SMTC was the account party, and CCM was the beneficiary.[95]

The court pointed out two interrelated features of the letter of credit providing its unique value in the marketplace, and are critical to the analysis of the United States claim. First, "[t]he simple result [of a letter of credit] is that the issuer substitutes its credit, preferred by the beneficiary, for that of the account party."[96] The issuing bank pays the beneficiary out of its own funds and then must look to the account party for reimbursement.[97] Second, the issuer's obligation to pay on a letter of credit is entirely independent of the underlying commercial transaction between the beneficiary and the account party.[98] Furthermore, the issuer must honor a proper demand for payment from the beneficiary even if that beneficiary breached the underlying contract.[99] This principal of independence is universally viewed as essential to the proper functioning of a letter of credit and to its particular value, i.e., certainty of payment.[100]

This assurance of payment gives letters of credit a central role in commercial dealings, and gives them a particular value in international transactions, "in which sophisticated investors knowingly undertake such risks as political upheaval or contractual breach in return for the benefits in return for the benefits to be reaped from international trade."[101] Therefore, the courts have concluded that the purpose of the letter of credit would be defeated by examining the merits of the underlying contract dispute to determine whether the letter should be paid.[102]

After analyzing the characteristics of a letter of credit, the court

94. *Centrifugal*, 966 F.2d at 1351.

95. Additionally, BNL was a confirming bank and thus became directly liable to CCM. A "confirming bank" is one which will either itself honor the letter of credit already issued by another bank or guarantees that such a credit will be honored by the issuer or a third bank. *See* OKLA. STAT. tit. 12A, § 5-103(1)(f)(1963). "A confirming bank by confirming a letter of credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of the issuer." *Id.* § 5-107(2).

96. Arbest Constr. Co. v. First Nat'l Bank & Trust Co., 777 F.2d 581, 583 (10th Cir. 1985). *See also* Republic Nat'l Bank v. Fidelity & Deposit Co., 894 F.2d 1255, 1258 (11th Cir.), *cert. denied*, 111 S. Ct. 308 (1990) (letter of credit gives the beneficiary and irrevocable right to payment, not from the account party, whom might become insolvent or refuse to pay, but from the issuing bank); Airline Reporting Corp. v. First Nat'l Bank, 832 F.2d 823, 826 (4th Cir. 1987) (issuer replaces customer's promise to pay with its own promise to pay); Pringle-Associated Mort. Corp. v. Southern Nat'l Bank, 571 F.2d 871, 874 (5th Cir. 1978) (beneficiary's claim based on letter of credit, not on agreement between issuer and account party and not on the underlying contract).

97. *See generally* Republic Nat'l Bank v. Fidelity & Deposit Co., 894 F.2d 1255, 1257-58 (11th Cir. 1990) (issuer which has honored demand for payment is entitled to immediate repayment).

98. *Centrifugal*, 966 F.2d at 1352. *See also* Ward Petroleum Corp. v. Federal Deposit Ins. Corp., 903 F.2d 1297, 1299-1300 (10th Cir. 1990).

99. *Centrifugal*, 966 F.2d at 1352.

100. *Id. See, e.g.*, Wood v. R.R. Donnelley & Sons Co., 888 F.2d 313 (3d. Cir. 1989); Tradax Petroleum Am., Inc. v. Coral Petroleum, Inc., 878 F.2d 830 (5th Cir. 1989).

101. *Centrifugal*, 966 F.2d at 1352 (quoting Enterprise Int'l, Inc. v. Corporacion Estatal Petrolera Ecuatoriana, 762 F.2d 464, 474 (5th Cir. 1985)).

102. *Id.* at 1353.

concluded that Iraq did not have a property interest in the money CCM received under the letter.[103] The court rejected the contention that Iraq had a property interest in this money as an alleged contract payment made by Iraq, recoverable by Iraq because CCM breached the contract.[104] In doing so, the United States made a breach of contract claim on behalf of Iraq that Iraq never made, created a remedy for the contracting parties in derogation of the remedy they themselves provided[105] and, most importantly, disregarded the controlling legal principles with respect to letters of credit.[106]

In support of the decision, the court emphasized that the payment to CCM under the letter of credit was not made by Iraq, but rather, it was made by the confirming bank, BNL.[107] Furthermore, no legal authority supported the contention that Iraq, as an account party on a letter of credit, had a property interest in the beneficiary's payment based on the beneficiary's alleged breach of the underlying contract.[108] In fact, such a conclusion would be antithetical to the principle of independence that is universally recognized by the courts as crucial to the use of the letter of credit as a financing device.[109] Reliance on the underlying contract is contrary to the unique value of the letter of credit.[110] Payment certainty would be undermined by concluding that the account party had a right to that payment by virtue of the underlying contract prior to litigation on that contract.[111] The beneficiary's bargained for right to retain the payment pending contract litigation would be effectively frustrated.[112]

In conclusion, the court reiterated its recognition that Iraqi assets and property interests should be construed in the broadest sense.[113] However, the court declined to restructure the essential characteristics

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103. *Id.*
104. *Id.*
105. The parties themselves provided a remedy through a standby letter of credit in favor of the agent of SMTC, by which SMTC could recover the down payment in the event of a breach by CCM. *Id.* at 1353 n.6. Furthermore, the parties agreed to an expiration date for the standby letter of credit. *Id.* The district court found that this letter expired under its own terms before a proper draw was made upon it. *Id.* The United States did not appeal this ruling. *Id.*
106. *Id.* at 1353.
107. *Id.*
108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.* The United States' reliance on Itek Corp. v. First Nat'l Bank, 704 F.2d 1 (1st. Cir. 1983), *aff'd*, 730 F.2d 19 (1984), was not persuasive because that case was factually distinguishable in significant respects. In *Itek*, the First Circuit Court was concerned with essentially identical Executive Orders and regulations with the exception that the assets being frozen were Iran's. Under the letter of credit in that case, Iran was the beneficiary under the letter and thus Iran had a cognizable beneficial interest in the letter. *Id.* at 8. The position of Iran in *Itek* is analogous to Iraq's position as beneficiary of the standby letter of credit in this case. Once again the Tenth Circuit Court emphasized that the United States did not appeal the district court's ruling that any right that Iraq had under the standby letter of credit was extinguished when it expired. *Centrifugal*, 966 F.2d at 1354 n.7.
113. *Centrifugal*, 966 F.2d at 1353.

of a letter of credit in order to create a property interest in the payment made to CCM under the letter of credit.[114] "The national interest is not furthered by creating a property interest out of conditions that would not otherwise generate such an interest, particularly when we must do so at the expense of a critical and unique devise of international trade."[115]

### 3. Analysis

As stated previously, widespread confusion exists in the legal community concerning the use of letters of credit.[116] Our economy has become more global in nature, and as a result, the use of letters of credit has expanded dramatically in the past decade. Increased use results in a predictable increase in litigation construing letters of credit. As in the *Centrifugal* case, the transactions underlying the use of letters of credit are often very complex, involving numerous international parties and large sums of money.

In *Centrifugal*, the Tenth Circuit perceptively recognized the confusing issues surrounding letters of credit as well as the unique qualities that make them a valuable tool in foreign commerce. Unlike the United States, as intervenor, the Tenth Circuit remained focused on the issues of the case and did not involve itself in patriotic fervor by trying to create an Iraqi interest where one did not exist.

The *Centrifugal* opinion was a successful attempt to shed light and provide understanding of the complexities and desirable characteristics of this payment device. The Tenth Circuit's decision was based on well entrenched law governing letters of credit, providing a simple and understandable analytical framework that practitioners can turn to examine issues raised by the use of letters of credit.

## IV. Conclusion

During the 1992 survey period, the Tenth Circuit opinions in *Canfield* and *Davis* continued the court's trend of empowering the FDIC and federal prosecutors by broadly interpreting statutes relating to the failures and abuses in the banking and savings and loan industry. Unlike the *Davis* decision, which was based on established law in other circuits, the *Canfield* opinion is significant in that it is a case of first impression at the appellate level.

The Tenth Circuit based its opinion in *Centrifugal*, like the *Davis* decision, upon established legal doctrine. However, the opinion is notable because it recognizes the widespread confusion surrounding the use of letters of credit as well as the special value of these instruments in inter-

114. *Id.*
115. *Id.* at 1354.
116. *See supra* notes 73-77.

national commerce. The opinion provides a well organized analysis of this financing device and its use.

*Timothy K. Jordan*

# CONSTITUTIONAL LAW SURVEY

## I. INTRODUCTION

During the survey period, the Tenth Circuit attempted to give constitutional definition to individual rights where the Supreme Court had left the contours of those rights subject to specific factual circumstances. A majority of the decisions addressed constitutional issues in the context of Civil Rights litigation due to the increasing use of Civil Rights laws to determine the existence of duties arising when government action affects individual rights. Cases selected for this Survey, involving the First Amendment right of government employees to speak on issues of public concern and the Fourteenth Amendment right to personal safety and security while in custody of the state, evidence doctrine subject to shifting when dependent on different factual circumstances. Cases involving sovereign immunity and a pretextual prosecution to suppress speech are indicative of: (1) the need for a constant watchful eye of the judiciary to protect individual rights from ever-changing political objectives; (2) the fact that concepts of federalism are alive and well and require revisiting our constitutional roots. Each case is analyzed to provide the practitioner with its jurisprudential foundation and to indicate the impact that these decisions may have in the future.

## II. FIRST AMENDMENT — FREEDOM OF EXPRESSION

### A. *Matters of Public Concern*

The United States Supreme Court first addressed a public employee's First Amendment right to speak on issues of public concern in *Pickering v. Board of Education*.[1] The two-prong analysis set forth in *Pickering* requires: (1) that the speech was on a matter of public concern;[2] and (2) on balance, the speaker's right to speak as a citizen on matters of public concern outweighs the state employer's interest in promoting the efficiency of the public services it performs through its employees.[3] Matters of "public concern" relate to "any matter of political, social, or other concern to the community."[4] When the speech concerns a matter "only of personal interest, absent the most unusual circumstances" the actions of the employer are not subject to a First Amendment challenge. The Tenth Circuit Court of Appeals was faced with applying *Pickering* and its progeny in three different areas: racial discrimination, government corruption, and sexual harassment.

1. 391 U.S. 563 (1968).

2. *Id.* at 569. The analytical framework for determining what is of concern to the public was not specifically developed as this issue in *Pickering* was determined on the facts of the case. *See infra* note 4 and accompanying text for a standard used to determine what is of "public concern".

3. Connick v. Myers, 461 U.S. 138 (1983).

4. *Id.*

1. Tenth Circuit Cases

a. *Racial Discrimination and Government Corruption*: Patrick v. Miller[5]

*Patrick* involved a city finance director speaking on behalf of a co-employee. The appeal arose out of a suit filed by Fred L. Patrick, former Finance Director and City Controller of the City of Norman, Oklahoma. Patrick alleged that his employment was terminated because of statements made in his capacity as Chairman of the City of Norman Retirement Board and as supervisor of the city print shop.[6] Patrick assisted a print shop employee in preparing the employee's racial discrimination case against the city and questioned the city's use of retirement funds to balance the budget.[7] One month later, the city terminated Patrick's employment.

Patrick filed suit under 42 U.S.C. §§ 1981 and 1983 alleging violations of his statutory rights under § 1981 and his constitutional rights under the First and Fourteenth Amendments.[8] The defendants[9] moved for summary judgment based on the doctrine of qualified immunity. The district court denied the defendants' motion with respect to the § 1983 claim but granted their motion with respect to the § 1981 claim.

The defendants appealed and Patrick cross-appealed. The court of appeals affirmed the district court with respect to the § 1983 claim but reversed and remanded with respect to the § 1981 claim.[10] The single issue before the court was whether those defendants named individually were to be protected by qualified immunity.[11] The court's analysis of this issue required a determination using the test created in *Harlow v. Fitzgerald*.[12] Under *Harlow*, Patrick was required to show that his First

5. 953 F.2d 1240 (10th Cir. 1992) (Before McKay, Barrett and Brorby, J.) (Opinion by Brorby, J.).

6. *Id.* at 1242. These positions were part of Patrick's official responsibilities as Finance Director and City Controller. *Id.*

7. *Id.* Both incidents occurred during June of 1988. Shirley Franklin, a print shop employee, initiated a racial discrimination complaint against the city on May 18, 1988. Patrick intended to help Franklin with her complaint and met with the City Attorney on June 23 to discuss his possible involvement. On June 21, Patrick expressed his concerns regarding the retirement funds during a meeting of the City of Norman Retirement Board. During this meeting, the Retirement Board voted to seek the City Attorney's opinion as to the propriety of the use of retirement funds.

8. 42 U.S.C. § 1983 provides in relevant part:

> Every person who, under color of any statute, ordinance, custom, or usage, of any State . . . subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges or immunities secured by the Constitution . . . shall be liable to the party injured in an action at law. . . .

42 U.S.C. § 1983 (1988).

9. The original defendants included Eugene Miller, the City Manager, John Bloomberg, the Director of Administrative Services as well as the city of Norman. On appeal, "defendants" includes only Miller and Bloomberg.

10. *Patrick*, 953 F.2d at 1251-52.

11. *Id.* at 1243.

12. 457 U.S. 800 (1982). This test required a determination of whether a defendant had violated "clearly established statutory or constitutional rights of which a reasonable person would have known" at the time the challenged conduct occurred. *Id.* at 818.

Amendment rights in speaking out were established at the time of his firing.[13] In the government employer/employee context, Patrick would make a sufficient showing of established rights under *Harlow* by meeting the *Pickering* test.[14] Satisfying the *Pickering* test in this case required a showing that Patrick had a clearly established constitutional right to speak on behalf of his co-employee on the issue of racial discrimination, or to speak out against perceived governmental misconduct as a matter of public concern.

The court initially focused on Patrick's action with regard to the co-employee's racial discrimination claim.[15] The court determined the first prong of the *Pickering* test was met based on Patrick's statements regarding employer practices that affected a co-employee rather than himself.[16] Defendants asserted that the statements should be regarded as a personal grievance or an internal personnel matter, and as such, were not protected by the First Amendment.[17] The court disagreed. Although the precise content of Patrick's statements were not evidenced by the record, the fact that the statements were in opposition to racially discriminatory practices and were made in the presence of numerous individuals was sufficient to characterize them as matters of social concern to the community.[18] Furthermore, the subject matter of the statements was of public concern regardless of the fact that the statements were directed to city officials.[19]

Patrick's statements regarding potential illegalities in the city budget process were made pursuant to the duty imposed by his position as trustee of the retirement fund.[20] The court viewed his statements in context. Patrick spoke during a public meeting addressing matters of political and social concern. Furthermore, the court found that Patrick's statements were unmotivated by personal interest or hostility. He merely asked if proper budgetary procedures had been followed. Under these circumstances, Patrick's statements regarding the city budget were "clearly established" protected speech.[21] After concluding that the statements on racial discrimination and budgetary improprieties were matters of "public concern", the court proceeded to the second prong of the *Pickering* test; balancing the speaker's right to speak as a citizen against the city's interest in promoting the efficiency of its employees.

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13. Patrick's other constitutional claim, that the Defendants deprived him of his property interest in continued employment without due process of law in violation of the fourteenth amendment, required him to show he had a property interest in continued employment with the City of Norman. *See* Graham v. City of Okla. City, 859 F.2d 142 (10th Cir. 1988). A property interest in continued employment is a question of state law and therefore that portion of this case is omitted from this survey.

14. *Patrick*, 953 F.2d at 1246-47.

15. *Id.*

16. *Id.*

17. *Id.* at 1247.

18. *Id.*

19. *Id. See also* Givhan v. Western Line Consol. Sch. Dist., 439 U.S. 410 (1979) (employee's private communication with employer protected by first amendment).

20. *Patrick*, 953 F.2d at 1242.

21. *Id.* at 1248.

The court found Patrick's interest in speaking out against racial discrimination and budgetary impropriety as "self-evident."[22] In evaluating the defendants' interest in effective functioning of government, the court noted the lack of support in the record for the defendants' assertions that Patrick's statements regarding budgetary improprieties were false, interfered with the budget process or discredited their integrity.[23] The defendants also failed to demonstrate any governmental interest justifying the suppression of statements regarding racial discrimination.[24] The court affirmed the district court since Patrick, having met the *Pickering* test, satisfied the *Harlow* requirement.[25] Therefore, the defendants were not entitled to qualified immunity.

b. *Sexual Harassment*: Woodward v. City of Worland[26]

The Tenth Circuit Court of Appeals was faced again with applying the *Harlow* and *Pickering* tests in the context of § 1983[27] in *Woodward v. City of Worland*. The plaintiffs, former employees of the city of Worland, Wyoming, filed suit alleging they were subjected to sexual harassment by two of the defendants, Williams and Sackett (Officers).[28] The plaintiffs further alleged that the remaining defendants, Tolley and Seghetti (Supervisors) knew about the harassment and failed to curb it.[29] Furthermore, the plaintiffs alleged that, after complaining of the harassment, the defendants retaliated against them.[30] After the plaintiffs left the employ of the city, they filed suit under § 1983 asserting violations of their Fourteenth Amendment rights to equal protection and due process, as well as a violation of their First Amendment right of free speech.[31] The defendants moved for summary judgment of all claims based on qualified immunity under *Harlow*. Under qualified immunity, government officials generally are shielded from liability for civil damages for violating constitutional rights if their conduct does not violate "clearly established" constitutional rights of which a reasonable person

22. *Id.*

23. *Id.* This refers to the second prong of *Pickering* which requires a weighing of the speaker's interest in speaking against the government's interest in suppressing that speech to promote effective functioning of the public employer's enterprise.

24. *Patrick*, 953 F.2d at 1248.

25. *Id.* at 1249. (According to plaintiff's attorney, the case was settled prior to retrial.)

26. 977 F.2d 1392 (10th Cir. 1992)(Before Ebel, C.J. and McWilliams, Senior C.J. and Hunter, Senior District Judge. Opinion by Ebel, C.J.).

27. *See supra* note 8 for relevant text of 42 U.S.C. § 1983.

28. *Woodward*, 977 F.2d at 1394. Williams and Sackett were not co-employees or supervisors of the plaintiffs, however, the plaintiffs performed dispatch services and were required to interact directly with the officers. *Id.* at n.1.

29. *Id.* Tolley and Seghetti, were the officers' supervisors and were technically not employers of the plaintiffs'. As Police Chief and Sheriff, respectively, Tolley and Seghetti exercised authority over the plaintiffs and their working conditions as ex officio voting members of the JPB. *Id.* at n.2.

30. *Id.* Plaintiffs alleged that the harassment and retaliation that followed after reporting it to their supervisors was so intolerable that it amounted to a constructive discharge. Plaintiff Butler resigned in May 1987, plaintiffs Molina and DeSomber resigned in May 1990.

31. *Id.* at 1396. Due to the focus of this portion of the survey, the due process and equal protection claims will not be discussed.

would have known.[32] The district court denied the motion and defendants appealed.

The court of appeals reversed. The court applied the *Pickering* test to the statements made by the employees, first by determining whether the statements were of public concern.[33] If the statements did not regard matters of public concern, the plaintiffs would not have a "clearly established" right to First Amendment protections. How the court classifies particular speech under the public concern/personal concern distinction set forth by the Supreme Court in *Connick v. Myers*[34] focuses "on the motive of the speaker and attempt[s] to determine whether the speech was calculated to redress personal grievances or whether it had a broader public purpose."[35] The court found that the thrust of the plaintiffs' complaint was to stop the sexual harassment of them, personally and individually.[36] Although the complaint was personal, the court went on to determine whether the dispute addressed important constitutional rights in which society at large has an interest in protecting. If so, the speakers would therefore be afforded constitutional protection.[37]

Noting that no prior case has held that speech similar to the complaints of sexual harassment made by the plaintiffs pertained to a matter of public concern, the court declined to hold that plaintiffs' complaints were of public concern.[38] Additionally, the court cited the fact that the Officers, not acting as supervisors or co-employees of the plaintiffs, would not be liable under § 1983 for responding critically to the plaintiffs' speech.[39]

2. Analysis of Patrick and Woodward

The Tenth Circuit Court of Appeals has created a bright line distinction through its decisions in *Patrick* and *Woodward.* Government employees who speak on behalf of a racial minority or on behalf of the electorate are afforded the protection of the First Amendment when speaking on issues of racial discrimination or fiscal impropriety. Employees who speak for themselves, such as women on issues of sexual harassment in the workplace, are not. The different outcomes of *Patrick* and *Woodward* indicate a tediously slow recognition of constitutional protections where the alleged violation is based on sex.

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32. *Id.*
33. *Id.* at 1403-04.
34. 461 U.S. 138 (1983).
35. *Woodward*, 977 F.2d at 1403. The court cited an earlier Tenth Circuit decision, Conaway v. Smith, 853 F.2d 789 (10th Cir. 1988), which analyzed *Connick*. However, the specific analysis created in *Connick* determined whether speech was calculated to disclose misconduct or dealt with only personal disputes and grievances with *no relevance to the public interests*. This analysis has been construed as requiring a "motive of the speaker" determination. The difficulty in applying a motive requirement occurs when the speaker may have a mixed motive, as in the case of Patrick speaking on behalf of a subordinate because she worked for him, as well as because he suspected racial discrimination.
36. *Woodward*, 977 F.2d at 1403-04.
37. *Id.* at 1404.
38. *Id.*
39. *Id.*

The court in *Patrick* easily characterized the plaintiffs' statements regarding racial discrimination as a matter of social concern to the community while, at the same time, distinguishing these statements from internal grievances based on the fact that the statements were made on behalf of someone else. While this may be a simple resolution of the public concern/private concern problem addressed in *Connick*, it creates a distinction that is inconsistent with an individual's right to seek vindication of her or his own constitutional rights. Based on this distinction, if a government employee's constitutional rights are violated, they must rely on someone else to voice their defense. Luckily, in *Patrick*, the plaintiff's right to speak on the particular issues of racial discrimination and budgetary impropriety were "self-evident." Although the Supreme Court and the Tenth Circuit Court of Appeals have failed to provide specific guidance as to what is a "public concern," the issues of racial discrimination and malfeasance of government officials have historically been regarded as matters of social concern. Regardless of the events of recent past,[40] speaking out against the sexual harassment of an individual is not considered an issue of "public concern" in the Tenth Circuit.

In 1951 only one in three women participated in the labor force.[41] By 1986, half of all women in the United States worked outside the home or were looking for work.[42] The dramatic increase of women in the labor force has affected child care, elder care, and employee benefits, and has restructured the relationships between men and women in the workplace.[43] Incidents of sexual harassment have increased as well. Surveys conducted as early as 1963 characterized behavior by male coworkers, that would today be classified as sexual harassment, as acting "fresh" and dismissed such behavior as inconsequential.[44] By 1988, when the plaintiffs were allegedly harassed, such behavior was not considered inconsequential, costing federal taxpayers $267 million over a two year period because of lowered morale, loss of productivity, absences, job turnover and escalating litigation costs.[45] Sexual harass-

40. *See Gender, Race, and the Politics of Supreme Court Appointments: The Import of the Anita Hill/Clarence Thomas Hearings*, 65 S. CAL. L. REV. 1283 (1992) (selected essays and articles regarding the Senate Judiciary Committee hearings on alleged sexual harassment of Anita Hill by Supreme Court nominee Clarence Thomas). The hearings occurred pursuant to the "advice and consent" proceeding for Presidential appointment of Supreme Court justices "by and with the advice and consent of the Senate." U.S. CONST. art II, § 2, cl. 2.

41. *Women in the Work Force: Supreme Court Issues: Hearing Before the Subcommittee on Employment Opportunities of the Committee on Education and Labor*, 99th Cong., 2d Sess. 5 (Sept. 30, 1986) (statement of Jill Houghton Emery, Acting Director, Women's Bureau, Department of Labor).

42. *Id.*

43. *Id.* at 5-6.

44. LIN FARLEY, SEXUAL SHAKEDOWN, THE SEXUAL HARASSMENT OF WOMEN ON THE JOB 19-20 (1978). The author refers to a study conducted by the Hogg Foundation for Mental Health published in WOMEN VIEW THEIR WORKING WORLD (1963).

45. U. S. MERIT SYSTEMS PROTECTION BOARD, SEXUAL HARASSMENT IN THE FEDERAL GOVERNMENT: AN UPDATE 40 (1988) [hereinafter AN UPDATE]. The time period surveyed was May 1985 to May 1987. This study updated the U.S. Merit System's Protection Board's 1981 report on sexual harassment in the federal government. *Id.* at 12. The 1981 cost estimate was $189 million for the survey period May 1978 to May 1980. U. S. MERIT SYSTEMS PROTECTION BOARD, REPORT ON SEXUAL HARASSMENT IN THE FEDERAL WORK-

ment in the workplace has been and continues to be a matter of public concern.

The *Woodward* court's analysis of the plaintiffs' speech regarding sexual harassment focused on the "content, form and context" of their speech as revealed by the whole record.[46] Upon a review of the record, the court noted general references by the plaintiffs to the possibility that other women were subjected to the harassment.[47] Yet both parties stated that one of the plaintiffs, Beverly DeSomber, supported one of the other plaintiffs in her sexual harassment complaint.[48] The court also reasoned that the purpose or substance of the complaint did not assert that the sexual harassment prevented the Wyoming Joint Powers Board (JPB) from properly discharging its official responsibilities.[49] Yet the plaintiffs, as employees of the JBP responsible for discharging its official responsibilities, may have been subject to a hostile work environment which prevented them from performing their duties.[50] Finally, the alleged harassers were police and sheriff's officers sworn to uphold the law. They were charged with a duty that is comparable to, if not exactly the same as, the duty assumed by city officials for the management of public funds. If the officers were participating in behavior allegedly in violation of federal civil rights laws, the standard employed in *Patrick* for analyzing governmental corruption is applicable. Allegations that law enforcement officials are violating the law is a matter of political and social concern to the community.

Instead, the *Woodward* decision was premised on the personal nature of the allegations. The court failed to examine whether the allegations contained in the record would constitute a hostile work environment. All of the plaintiffs were personally subjected to sexual harassment. The Supreme Court, as well as the Tenth Circuit, have rec-

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PLACE: IS IT A PROBLEM? 76 (1981) [hereinafter Is IT A PROBLEM?]. Both reports noted that forty-two percent of the women surveyed experienced some form of sexual harassment during the survey period. AN UPDATE, *supra*, at 11; Is IT A PROBLEM?, *supra*, at 36. Fourteen percent of the men surveyed in 1988 and fifteen percent surveyed in 1981 experienced some form of sexual harassment during the survey period. AN UPDATE, *supra*, at 11; Is IT A PROBLEM?, *supra*, at 36.

46. Woodward v. City of Worland, 977 F.2d 1392, 1403 (10th Cir. 1992).

47. *Id.* at 1404 n.16.

48. Appellant's Opening Brief at 17, Woodward v. City of Worland, 977 F.2d 1392 (10th Cir. 1992) (No. 91-8034) ("As the supervising Dispatcher, DeSomber, after she supported Molina . . . alleges that Sheriff Seghetti pressured her to stop the complaint."); Appellees' Brief at 7, Woodward v. City of Worland, 977 F.2d 1392 (10th Cir. 1992) (No. 91-8034) ("Because of her own experiences and because she believed that no employee should have to put up with sexual harassment, Desomber openly supported Molina in her complaint against Williams. Sheriff Seghetti put pressure on DeSomber to stop Molina's complaint. . . ."); *Woodward*, 977 F.2d at 1396.

49. *Woodward*, 977 F.2d at 1404.

50. Sexual harassment severe or pervasive enough to actually affect the alleged victims work conditions creates a hostile work environment and is considered a violation of 42 U.S.C. § 2000 (1986). Meritor Sav. Bank, FSB v. Vinson, 477 U.S. 57, 67 (1986). The actions of the officers were alleged to include the following: rubbing the plaintiffs' necks, pinching and patting their buttocks and physical simulation of masturbation in the plaintiffs' presence. Appellees' Brief at 3, *Woodward* (No. 91-8034). There were also invitations for sex and statements such as "spread 'em baby", "I want your bod", and "I'd like to rip your tits off". *Id.* at 5.

ognized that sexual harassment need not be targeted at an individual, but may be so pervasive as to create a generally hostile work environment.[51] The crucial allegation in *Woodward* concerned retaliation for their complaints of sexual harassment.

If the actions of any one of or all of the defendants, by harassment or retaliation, constituted a hostile environment as to the female defendants, this situation is analytically indistinct from Patrick's speech on behalf of a black woman against racially discriminatory policies in city government. Patrick's speech was intended to redress a discriminatory practice as applied to one person. The result of *Woodward* begs the question. If one of the plaintiffs had stated, "I ask you to stop harassing me on behalf of all women," would their complaints then be protected from retaliation? To require such a statement to bring the issue under the ambit of "public concern" fails to recognize that we all have a right as citizens to speak out against oppression, regardless of where it occurs and who is the victim.

### B. *Pretextual Prosecution to Suppress Speech*

In *Bantam Books, Inc. v. Sullivan*, the Supreme Court recognized that freedom of expression is "vulnerable to gravely damaging, yet barely visible encroachments" requiring rigorous procedural safeguards.[52] *Bantam Books* involved a state commission's administrative restraint, by threatened prosecution of wholesalers, on the distribution of publications absent a judicial determination that such publications were lawfully banned. The Court imposed a heavy presumption against the constitutional validity of any system of prior restraint of expression and stated such a system would be tolerated only where it allowed judicial supervision and assurance of "almost immediate judicial determination of the validity of the restraint."[53]

Two years later in *Dombrowski v. Pfister*, the Court returned to the issue of prior restraint of speech upon review of a district court's denial of declaratory and injunctive relief.[54] The plaintiffs in *Dombrowski*, civil rights activists, asked the district court to enjoin the Louisiana state governor, law enforcement officials, and a legislative committee from prosecuting or threatening to prosecute them for violations of the Louisiana Subversive Activities and Communist Control Law and the Communist Propaganda Control Law.[55] The district court dismissed the complaint

51. Meritor Savings Bank v. Vinson, 477 U.S. 57, 65-66 (1986); Hicks v. Gates Rubber Co., 833 F.2d 1406, 1413 (10th Cir. 1987). There are two different types of sexual harassment claims recognized under Civil Rights laws: *quid pro quo* and hostile work environment. *Vinson*, 477 U.S. at 65. *Quid pro quo* sexual harassment occurs when the alleged victim is required to exchange sexual favors or tolerance of the harassment as a condition of continued employment. *Id.* Hostile work environment sexual harassment occurs when the workplace is so offensive such that it effects the proper performance of duties required for the employee's position. *Id.*

52. 372 U.S. 58 (1963).

53. *Id.* at 66-70.

54. Dombrowski v. Pfister, 380 U.S. 479 (1965).

55. *Id.* at 482.

and the court of appeals affirmed. The Supreme Court reversed, noting that the "chilling effect upon the exercise of First Amendment rights may derive from the fact of the prosecution, unaffected by the prospect of its success or failure."[56]

An unusual twist on prior restraint of speech may occur in the context of a criminal prosecution causing the indirect result of suppressing speech by subjecting the speaker to the costs of the criminal proceeding. In a criminal case, there is no constitutional right of appeal.[57] There is a statutory right of appeal for "final" decisions of district courts.[58] In *Abney v. United States* the Supreme Court addressed the issue of whether the denial of a motion to dismiss a criminal indictment was a "final" decision which would allow appellate review.[59] The Court's prior decision of *Cohen v. Beneficial Indus. Loan Corp.* created a collateral order exception to the final judgment rule of 28 U.S.C. § 1291.[60] The collateral order exception allows a court of appeals to review a non-final collateral order if the order meets three conditions: (1) the district court has fully disposed of the question, in no sense leaving the matter open, unfinished or inconclusive; (2) the decision resolves an issue completely collateral to the cause of action asserted; and (3) the decision involves an important right which would be irreparably lost if review has to await final judgment on the merits.[61]

In *Abney*, the Court determined that the collateral order exception was applicable to a motion to dismiss an indictment on double jeopardy grounds.[62] The collateral order exception could arguably be applied to other instances where constitutional rights may be affected if a criminal prosecution is allowed to proceed. For example, if a criminal defendant prosecuted under obscenity laws asserts that the prosecution was a pretextual attempt to chill his First Amendment rights, the continuation of the prosecutorial proceeding as pretext is an issue collateral to whether the speech is in violation of the criminal law.[63]

### 1. The Chilling of First Amendment Rights: *United States v. P.H.E.*[64]

The Tenth Circuit case of *United States v. P.H.E.* involved an "unu-

56. *Id.* at 487.

57. McKane v. Durston, 153 U.S. 684, 697 (1894).

58. 28 U.S.C. § 1291 (1988). "The courts of appeals . . . shall have jurisdiction of appeals from all final decisions of the district courts of the United States . . . except where a direct review may be had in the Supreme Court." *Id.*

59. Abney v. United States, 431 U.S. 651 (1977).

60. 337 U.S. 541 (1949).

61. *Id.*

62. *Abney*, 431 U.S. at 662. The Court held that "pretrial orders rejecting claims of former jeopardy . . . constitute 'final decisions' and thus satisfy the jurisdictional prerequisites of § 1291." *Id.*

63. *Id.* at 660-62. The issue of the guilt or innocence of the criminal defendant is separable from the issue of the practical effect of the trial on the defendant's constitutional rights. *Id.* at 659-60.

64. 965 F.2d 848 (1992) (before McWilliams, Moore and Aldisert, J.) (opinion by Aldisert, J.) (McWilliams, J., dissenting).

sual, perhaps unique confluence of factors."[65] In 1985 a United States Attorney from Utah sent a letter to Edwin Meese, then United States Attorney General, proposing a coordinated, nationwide prosecution strategy against companies that sold obscene materials.[66] The strategy called for multiple prosecutions at all levels of government in many locations.[67] The intent of bringing multiple prosecutions was to impose a financial burden on the companies such that the expense of defending the prosecutions would undermine profitability, resulting in the termination of the enterprise.[68] As a result of this letter, and other concerns related to pornography, the Attorney General created the National Obscenity Enforcement Unit to oversee the prosecution of obscenity violations nationwide.[69] The Justice Department's prior policy discouraged multiple obscenity prosecutions unless materials were unquestionably obscene.[70] In September 1987 the Justice Department changed its policy and encouraged multiple prosecutions against large organizations.[71]

The first action against PHE[72] began in 1986 in North Carolina and ended in an acquittal in 1987.[73] During plea negotiations in that case, prosecutors stated that the only way PHE could avoid multiple prosecutions was by ceasing distribution in *Utah* of "all sexually oriented materials" *including some materials protected by the First Amendment*.[74] PHE declined to cease distribution and spent more than $700,000 defending the prosecution in North Carolina. Subsequently, a federal grand jury in the Western District of Kentucky subpoenaed documents as part of an investigation in that state, and the United States Attorney's office in Utah began to coordinate prosecutorial efforts between Kentucky, Utah and North Carolina.[75]

The defendants sought an injunction in the Federal District Court

65. *Id.* at 855.

66. *Id.* at 850. The attorney who drafted the letter was Mr. Brent Ward.

67. *Id.* (Ward and Assistant United States Attorney Richard Lambert developed the idea of multiple prosecutions).

68. *Id.* This goal was initially posited by Ward in his first letter to the Attorney General.

69. *Id.* at 851.

70. *Id.* A prior and unrelated case where PHE sought and was granted an injunction against multiple prosecutions in the District Court for the District of Columbia notes the change in policy as reflected in amendments to the United States Attorney's Manual occurring between 1986 and 1988. PHE, Inc. v. United States Dep't of Justice, 743 F. Supp. 15, 19 (D.D.C. 1990). *See also* UNITED STATES COMMISSION ON OBSCENITY AND PORNOGRAPHY, THE REPORT OF THE COMMISSION ON OBSCENITY AND PORNOGRAPHY 387 (1970) [hereinafter PORNOGRAPHY COMMISSION, 1970 REPORT]. The report notes the difficulties of defining what is legally obscene. This results in "exceedingly rare" enforcement of obscenity laws with "campaigns" being conducted by police and prosecutors in response to citizen complaints "to make the public periodically aware of law enforcement 'concern' with obscenity." *Id.*

71. *P.H.E.*, 965 F.2d at 851. It is unclear whether this change in policy was due to Ward's letters or to some other reason.

72. Throughout the remainder of this discussion, "PHE" collectively refers to the appellants PHE and any one of the number of defendants named individually.

73. *P.H.E.*, 965 F.2d at 851.

74. *Id.* Materials included *Playboy* Magazine and DR. ALEX COMFORT, THE JOY OF SEX (1972). *Id.* at 852.

75. *Id.* at 851.

for the District of Columbia against the Department of Justice and various individuals to bar prosecutors from causing or permitting indictments for violations of federal statutes prohibiting the mailing of obscene or crime inciting matter to be returned against them in more than one federal judicial district within the United States.[76] A preliminary injunction was granted pending the Court's ruling on a permanent injunction.[77] Subsequently, a Utah grand jury returned an indictment against PHE which was the subject of this appeal.[78] The defendants sought further injunctive relief in the Federal District Court for the District of Columbia which was denied.[79]

In Utah, PHE moved for dismissal claiming the prosecution was in bad faith and was brought in retaliation for the injunction.[80] The district court denied the motion, citing the defendants' failure to connect prosecutorial conduct which occurred in North Carolina and Kentucky with the decision to seek an indictment against the defendants in Utah.[81] The court of appeals reversed concluding that the defendants had satisfied their burden of showing pretext. On remand the burden shifted to the government to justify its decision to prosecute with "legitimate, articulable, objective reasons."[82]

a. *Majority Opinion*

The majority began its opinion by confirming jurisdiction through the application of the collateral order exception. The review of the record for pretext was required because if the prosecution was allowed to continue, the defendant's First Amendment rights would be lost if review had to await final judgment.[83] The government asserted that the defendants' rights could be protected on appeal from conviction, citing *United States v. Hollywood Motor Car Co.*[84] The majority rejected this assertion since *Hollywood Motor Car* involved the protection of a procedural right under the Federal Rules of Civil Procedure, a concern less pressing than the defendants' First Amendment rights.[85] The majority proceeded to analyze the defendants' appeal under those cases in which a prosecutor threatened the actual exercise of First Amendment rights.[86]

76. PHE, Inc. v. United States Dep't of Justice, 743 F. Supp. 15, 28 (D.D.C. 1990) (quoted in *P.H.E.*, 965 F.2d at 852).

77. *Id.*

78. *P.H.E.*, 965 F.2d at 852.

79. PHE, Inc. v. Dep't of Justice, No. 90-0693(JHG), 1991 WL 25753 (D.D.C. Feb. 6, 1991) (unpublished order).

80. *P.H.E.*, 965 F.2d at 852.

81. *Id.* at 852-53.

82. *Id.*

83. *Id.* at 853-54.

84. 458 U.S. 263 (1982) (per curiam). This case involved the prosecution for the violation of customs laws. The defendant asserted rights under the Federal Rules of Civil Procedure for a change of venue and was subject a superseding indictment charging four new counts. The defendant moved for dismissal of the indictment on grounds of vindictive prosecution. *Id.*

85. *P.H.E.*, 965 F.2d at 855.

86. *Id.* at 855-56.

Drawing primarily from Supreme Court the decisions of *Bantam Books, Inc. v. Sullivan*,[87] *Dombrowski v. Pfister*,[88] and the most recent decision of *Fort Wayne Books Inc. v. Indiana*,[89] the majority noted that "the state may not use the agents and instrumentalities of law enforcement to curb speech protected by the First Amendment."[90] Because the defendants asserted that the act of going to trial under a pretextual prosecution would have a chilling effect on protected expression, the right asserted is a "right not to be tried."[91] Therefore, the right which would be lost if the prosecution were allowed to continue was the right to be free from the chilling of protected rights under the First Amendment.[92] Finally, citing *Bender v. Clark*,[93] the majority recognized that even if the issue is not collateral, justice requires immediate review where the danger of injustice by delaying review outweighs the inconvenience and costs of piecemeal review.[94]

b. *Dissenting Opinion*

The dissenting opinion focused on the majority's acceptance of the appeal for review. Relying on *Hollywood Motor Car*[95] and *United States v. Butterworth*,[96] the dissent noted the crucial distinction between a "right not to be tried" and a right whose remedy may require dismissal of charges in post-conviction proceedings. The "right not to be tried" can only be vindicated prior to trial.[97] The dissent simply failed to see how the defendants in this case had a right not to be tried.[98] Furthermore, the majority's reliance on *Bender* as an alternative cause for review was dismissed as being impertinent at this time.[99]

2. Analysis

The dissent's failure to see how the defendants had a right not to be tried requires an analysis of the majority's application of prior doctrine as well as of the inability to vindicate freedom of expression once restrained. The dissent correctly notes that two of the cases relied upon by the majority, *Dombrowski* and *Fort Wayne Books*, did not involve the question of whether the denial of a motion to dismiss a grand jury indictment is immediately appealable.[100] Those cases discussed circumstances where a defendant's constitutional rights would be irreparably

87. 372 U.S. 58 (1963). *See supra* note 52 and accompanying text.
88. 380 U.S. 479 (1965). *See supra* note 54 and accompanying text.
89. 489 U.S. 46 (1989).
90. *P.H.E.*, 965 F.2d at 856.
91. *Id.* (quoting United States v. Hollywood Motor Car Co., 458 U.S. 263, 267 (1982)).
92. *Id.*
93. 744 F.2d 1424 (10th Cir. 1984).
94. *P.H.E.*, 965 F.2d at 857.
95. 458 U.S. 263 (1982).
96. 693 F.2d 99 (9th Cir. 1982).
97. *P.H.E.*, 965 F.2d at 862.
98. *Id.*
99. *Id.*
100. *Id.*

lost if the proceeding below was to continue without review.[101] But although the analysis in *P.H.E.* was performed under the collateral order doctrine, the court of appeals focused on the third prong of this analysis.[102] A review under the third prong is analytically consistent with the review of a denial of injunctive relief performed in *Dombrowski*.[103] Furthermore, adjudicating the proper scope of the First Amendment protections has been recognized as a federal policy that merits application of an exception to the general finality rule.[104] The *Fort Wayne Books* rationale allowing for review where refusal to do so "might seriously erode federal policy" is applicable to this appeal.[105] Not only may PHE's constitutional rights be eroded, but the integrity of the United States government may also be questioned if a lengthy trial, resulting in tremendous taxpayer expense, were to result in a reversal due to a pretextual prosecution.[106]

Next, the district court's conclusion that PHE had failed to connect the questionable behavior of Utah Assistant United States Attorney Lambert's involvement in both the North Carolina case and the prosecution in this case formed the basis for the finding of lack of unconstitutional motivation by prosecutors.[107] The Tenth Circuit found the district court's conclusion "clearly erroneous" on the facts and found its allowance of prosecutors to proceed on the "tainted" indictment as er-

101. What these cases did examine was the chilling of First Amendment rights by actions short of physically confiscating materials by the state. In *Dombrowski*, the plaintiffs were threatened with prosecution under a state Communist propaganda control law. The Court noted that "determining the contours of the regulation would have to be hammered out case by case—and tested only by those hardy enough to risk criminal prosecution to determine the proper scope of the regulation." *Dombrowski*, 380 U.S. at 487.

In *Fort Wayne Books*, the Court noted that the "probable cause" standard for allowing seizures under the fourth amendment was not adequate to remove books or films from circulation believed to be obscene but not judicially determined to be so. *Fort Wayne Books v. Indiana*, 489 U.S. 46, 63 (1989).

102. *P.H.E.*, 965 F.2d at 854-55.

103. *See supra* note 61 and accompanying text. In *Dombrowski*, the Court noted that there was no immediate prospect of a final state adjudication, uncertainty that the prosecutions would resolve all constitutional issues, and that a series of state criminal prosecutions would not provide satisfactory resolution of constitutional issues. *Dombrowski*, 380 U.S. at 489.

104. *See, e.g.*, National Socialist Party of Am. v. Village of Skokie, 432 U.S. 43, 44 (1977).

105. *Fort Wayne Books*, 489 U.S. at 55. *Fort Wayne Books* applied an analysis recognized in Cox Broadcasting Corp. v. Cohn, 420 U.S. 469 (1975), for reviewing cases as "final" even though further proceedings are pending in state courts. An application of *Cox* turns on whether a refusal to immediately review the state court decision might "seriously erode federal policy." *Cox*, 420 U.S. at 482-83.

106. *See P.H.E.*, 965 F.2d at 851. Defendant spent $700,000 in connection with the North Carolina prosecution that ended in acquittal. Although the cost of prosecution is not determined, any figure close to this amount, expended solely in an attempt to drive a defendant out of business rather than secure a criminal conviction pursuant to federal statutes, would call into question the government's allocation of resources.

107. "As the government convincingly notes, there is no allegation of bad faith motivation on the part of Benson [the Utah prosecutor] nor is any improper motive to be found in the prosecution memorandum prepared by Lambert and upon which Benson relied in deciding to seek an indictment." Memorandum Decision and Order at 7, United States v. P.H.E. Inc., Case No. 90-CR-177W (C.D. Utah Aug. 28, 1991).

ronous as a matter of law.[108] The fact that the indictment was issued by an independent grand jury was insufficient to remove the "taint" of a pretextual prosecution that had begun years earlier in other jurisdictions.

The larger issue is the Department of Justice's use of federal funds to pursue a political agenda outside of the bounds of First Amendment jurisprudence.[109] Such pursuits are reflective of a form of "pragmatic liberal affirmative action" where government on behalf of the "better" interests of society espouses "normative standards regulating sexual desire and depictions."[110] Where the focus is limited by a political agenda to inhibit a particular form of constitutionally protected expression, it is the duty of the judiciary to widen this focus and direct attention to the true liberty interest at stake.

The majority's use of the collateral order doctrine analysis merely provided a framework for analyzing the "unique confluence of factors" involved in this particular case. The collateral order doctrine is equally applicable in both civil and criminal proceedings.[111] The "final decision" which would allow review requires a practical rather than technical construction.[112] In this case, the final decision of the district court—that pretext was not a factor—would result in the continuation of the prosecution. The defendants, if correct in their assertion that the goal of the government was to make the defense of the prosecution cost prohibitive, could not possibly vindicate their First Amendment rights post-trial as their ability to distribute their goods was already impaired.[113] Thus, the government's use of the vehicle of the trial may result in a chilling of the defendant's First Amendment rights. Where the government uses the threat of trial as a pretext for closing down the defendant's operation, "the case would clearly implicate First Amendment concerns and require analysis under the appropriate First Amendment

108. *P.H.E.*, 965 F.2d at 857-60.

109. The change in philosophy by prevailing political winds is evident by a comparison of two separate reports from the Attorney General's Commission on Pornography. In 1970, the Commission recognized that there was some value of pornography through the exchange of dialogue concerning obscenity and an opportunity for the development of healthy attitudes toward sexuality. *See generally*, PORNOGRAPHY COMMISSION, 1970 REPORT, 233-56, 309-38.

> A 1986 report from the same Commission found almost no value in pornography:
> Still, when we look at the standard pornographic item in its standard context of distribution and use, we find it difficult to avoid the conclusion that this material is so far removed from any of the central purposes of the First Amendment, and so close to so much of the rest of the sex industry, that including such material within the coverage of the First Amendment seems highly attenuated.

1 U. S. DEP'T OF JUSTICE, ATTORNEY GENERAL'S COMM'N ON PORNOGRAPHY: FINAL REPORT 267 (1986).

110. DONALD A. DOWNS, THE NEW POLITICS OF PORNOGRAPHY 26 (1989). The author discusses the effect of conservative politics on traditional standards of liberty.

111. Abney v. United States, 431 U.S. 651, 659 n.4 (1977).

112. Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541, 546 (1949). A technical construction would require an adjudication on the issue of guilt or innocence, rather than allowing an expedited review of the infringement of constitutional rights.

113. The Supreme Court has recognized that freedom of the press embraces circulation, the right to receive, as well as publication. Lovell v. City of Griffin, 303 U.S. 444, 452 (1938).

standard of review."[114]

## III. ELEVENTH AMENDMENT—SOVEREIGN IMMUNITY

In *Ex parte Young*,[115] the Supreme Court held that the Eleventh Amendment[116] does not bar a federal court injunction to stop state officials from enforcing state laws that violate the United States Constitution. Sixty-six years later in *Edelman v. Jordan*,[117] the Supreme Court revisited *Young* and allowed a federal court injunction and prospective relief consistent with the requirements of the Equal Protection Clause of the Fourteenth Amendment.[118] While *Edelman* went further to deny the award of retroactive benefits as a violation of Eleventh Amendment immunity, prospective relief was granted in both cases to individuals whose constitutional rights had been violated.[119] The division created by *Young* and *Edelman*—that a state is not immune from injunctive relief but may assert immunity when faced with retroactive monetary relief—creates an analytical framework by which Eleventh Amendment sovereign immunity questions are to be determined. This requires a weighing of the right to the relief requested by an individual against the right of a state's citizens to have their public funds insulated from repercussions that may arise out of state officials performing their duties.

### A. *Relief Through Bankruptcy: In re Crook* [120]

The Tenth Circuit decision of *In re Crook* addressed the United States Bankruptcy Court's practice of "writing down" mortgages held by a state.[121] Under reorganization, 11 U.S.C. § 506(a) permits the bankruptcy court to declare debt to be secured up to the actual market value of the property, while the amount of debt beyond market value of the property becomes unsecured.[122] The portion of debt that becomes un-

114. Arcara v. Cloud Books Inc., 478 U.S. 697, 708 (1986) (O'Connor, J., concurring) (noting a city's use of a nuisance statute as pretext for closing down a bookstore because it sold indecent books as implicating the first amendment).

115. 209 U.S. 123 (1908).

116. The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." U.S. CONST. amend. XI.

117. 415 U.S. 651, 664 (1974).

118. The plaintiff in *Edelman* sued for injunctive and declaratory relief, alleging State officials had violated the Equal Protection Clause by non-compliance with federal regulations. *Id.* at 653.

119. *Young* involved the denial of due process rights under the Fourteenth Amendment. *Young*, 209 U.S. at 131. *Edelman* involved the denial of equal protection under the Fourteenth Amendment. *Edelman*, 415 U.S. at 653.

120. 966 F.2d 539 (10th Cir.) (before Anderson, Aldisert and Brorby, Circuit Judges) (opinion by Aldisert, Senior Circuit Judge, United States Court of Appeals for the Third Circuit, sitting by designation), *cert. denied*, 113 S. Ct. 491 (1992).

121. *Id.* The case involved the state of Oklahoma. "Writing down" occurs through the application of 11 U.S.C. § 506(a) (1988) of the bankruptcy code and is then applicable to the states, as is the rest of the code, through 11 U.S.C. § 106(c) (1988).

122. 11 U.S.C. § 506(a). The debtors applied for relief under Chapter 12 reorganization and as part of the reorganization included the writing down of the mortgages in the reorganization plan. *Crook*, 966 F.2d at 540.

secured is that part which is "written down." In *Crook*, the debtors had mortgaged property to the Commissioners of the Land Office, an agency of the State of Oklahoma.[123] The State foreclosed on the mortgages and the debtors filed for bankrupcty under Chapter 12.[124] Applying 11 U.S.C. §§ 506(a) and 106(c), the bankruptcy court declared the State's notes to be secured only up to market value, with the remainder of debt as unsecured.[125] The State appeared specially to contest the bankruptcy court's constitutional authority to exercise jurisdiction under § 106(c) over the State's mortgage interest.[126]

The argument advanced by the State in the bankruptcy court began by explaining state law and state constitutional provisions which enable public funds to be invested in mortgages.[127] If a portion of the mortgage is unrecoverable due to writing down, "depletion of state coffers through the exercise of unconsented state jurisdiction" for the loss incurred to the state mortgage fund would result.[128] The bankruptcy court rejected the State's contentions. Citing *Pennsylvania v. Union Gas*,[129] which permitted the abrogation of a state's immunity by Congress pursuant to the Commerce Clause, the bankruptcy court analogized the powers granted to Congress under the Commerce Clause and the Bankruptcy Clause thus permitting the abrogation of a state's immunity under both clauses.[130] Furthermore, the "unmistakably clear" language of § 106(c) made that portion of the bankruptcy code applicable to the states.[131]

The State appealed and the United States intervened.[132] The district court affirmed, applying the bankruptcy court's analysis. On fur-

123. *Crook*, 966 F.2d at 540.

124. *Id.* Chapter 12 of the bankruptcy code allows for reorganization rather than total relinquishment of assets. *See* 11 U.S.C.A. § 1205 (West Supp. 1992).

125. *Crook*, 966 F.2d at 540.

126. *Id.* at 539.

127. *Id.* at 540. The Oklahoma Constitution requires the reimbursement of funds, disbursed for purposes of financing mortgages, to state trust. *See* OKLA. CONST. art. XI, § 2; Oklahoma Enabling Act, ch. 3335, 34 Stat. 267 (1906).

128. *Crook*, 966 F.2d at 541 (quoting appellant's brief).

129. Pennsylvania v. Union Gas Co., 491 U.S. 1 (1989) (holding Article I power permits some abrogation of sovereign immunity).

130. Memorandum Order on State of Oklahoma, ex rel. Commissioners of the Land Office Objection to Jurisdiction, In re: Randy Crook, KK No. 89-3972-LN Chap. 12, (Bank. W.D. Okla. July 30, 1990). The bankruptcy court reasoned that the plurality opinion of *Union Gas* noted that the commerce clause both expands federal power and contracts state power. The contraction of state power by the commerce clause, coupled with the plenary power granted to Congress through the surrender of that portion of state sovereignty in Article I allowed for the abrogation of the states' eleventh amendment immunity through the bankruptcy clause. *Id.* at 7.

131. *Crook*, 966 F.2d at 541. *See also* 11 U.S.C. § 106(c) (1988).

132. Intervention occurred pursuant to 28 U.S.C. § 2403(a) providing, in relevant part:

> In any action, suit or proceeding in a court of the United States to which the United States or any agency, officer or employee thereof is not a party, wherein the constitutionality of any Act of Congress affecting the public interest is drawn in question, the court shall certify such fact to the Attorney General, and shall permit the United States to intervene for presentation of evidence, if evidence is otherwise admissible in the case, and for argument on the question of constitutionality.

28 U.S.C. § 2403(a) (1988).

ther appeal, the Tenth Circuit affirmed the judgment, not on the basis of Article I but rather on the basis that the relief against the State was declaratory or injunctive in nature and resulted in mere incidental expenditure of state funds.[133]

The court of appeals noted three issues for consideration: (1) whether § 106(c) contains "unmistakably clear" language indicating that Congress meant that section to apply against the states; (2) if so, whether Article I bankruptcy power authorizes Congress to abrogate Eleventh Amendment immunity through application of the bankruptcy laws; and (3) whether the bankruptcy court's ruling violates the Tenth Amendment.[134] Addressing the first issue, the court noted the recent Supreme Court decision of *United States v. Nordic Village, Inc.*,[135] which held that the application of § 106(c) did not establish a textual waiver of government immunity.[136] *Nordic Village* was then distinguished as an action for damages, while the case at hand concerned an action for injunctive and declaratory relief. Given this distinguishing factor, the analysis performed by the bankruptcy court using *Pennsylvania v. Union Gas* and Article I (state immunity balancing) was inapplicable. The court then analyzed the case using the *Ex parte Young* and *Edelman* line of cases.

Under § 1227(a) of the bankruptcy code, a bankruptcy court's approval of the debtors' reorganization plans, including the writing down of mortgages, is a declaratory order that binds each creditor.[137] Application of the general provisions of § 524(a) provides a discharge of obligation that voids any judgment obtained against the debtor and operates as an injunction against any action to recover on such debts.[138] Furthermore, citing *Hoffman v. Connecticut Income Maintenance Dep't*,[139] the court noted the Supreme Court's construction of § 106(c) where the determination of an issue that binds the governmental unit but does not require a monetary recovery from a state is more indicative of declaratory and injunctive relief.[140]

The State asserted that reliance on *Ex parte Young* and *Edelman* was misplaced because there was no unlawful act committed by the State.[141] The court disagreed noting that *Ex parte Young* and its progeny were con-

133. *Crook*, 966 F.2d at 540, 542-44.

134. The Tenth Amendment issue is not analyzed in this survey as it was decided under Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985), and involves no novel issue for consideration.

135. 112 S. Ct. 1011 (1992).

136. *Id.* at 1017. *Nordic Village* involved an adversarial proceeding by a trustee in bankruptcy against the Internal Revenue Service to recover corporate funds used illegally to pay an individual's tax liability. The Supreme Court addressed federal immunity under § 106(c).

137. *Crook*, 966 F.2d at 543. The relevant portion of 11 U.S.C. § 1227(a) provides: "[T]he provisions of a confirmed plan bind the debtor [and] each creditor . . . whether or not the claim of such creditor . . . is provided for by the plan, and whether or not such creditor . . . has objected to, has accepted, or has rejected the plan. 11 U.S.C. § 1227(a) (1988).

138. *Crook*, 966 F.2d at 543.

139. 492 U.S. 96 (1989).

140. *Crook*, 966 F.2d at 543.

141. *Id.*

cerned with the relationship between two sovereigns rather than the grant of relief by a party aggrieved.[142] This case involved two competing interests, the State's interest in protecting its financial investment and the bankruptcy courts interest in settling the debtors accounts in accordance with bankruptcy laws.[143] In this case, the court found no violation of the Eleventh Amendment in resolving these competing interests.[144]

B. *Analysis*

By construing the act of writing down a mortgage under the bankruptcy code as part of a larger request for injunctive or declaratory relief, the court of appeals was able to hold that Eleventh Amendment immunity is not compromised by the application of certain provisions of the bankruptcy code. While such a construction may be sufficient to adjudicate this particular factual situation, it fails to answer the question posed by the State of Oklahoma: does action by the Federal Judiciary taken on behalf of a individual against the legal rights of a state constitute a violation of sovereign immunity?

The court of appeals correctly concluded that the bankruptcy court's actions with respect to following the letter of the bankruptcy code provides relief that is injunctive in nature.[145] However, the issue concerns the devaluation of property under 11 U.S.C. § 506(a) and the application of this provision to a state held legal interest. While it is true that the Supreme Court decision of *Nordic Village* involved a claim for monetary damages, that decision held that § 6(c) did not establish a waiver of governmental immunity from a bankruptcy trustee's claims for monetary relief.[146] If no waiver on the part of Oklahoma is established through § 6(c) then the resolution with respect to sovereign immunity turns on how "writing down" under § 506(a) is to be construed.

Applying § 506(a) by "writing down" results in a devaluation of the state's economic interest yielding two results. The state is restrained from pursuing common law remedies and is compelled by state law to reimburse the state trust. This result highlights the Supreme Court's division of Eleventh Amendment jurisprudence characterized by *Young* and *Edelman*. The reasoning of *Edelman*[147] applies to the second result of "writing down." The state is compelled to reimburse the trust by the

142. *Id.*
143. *Id.*
144. *Id.* at 544.
145. *See supra* notes 118 & 119 and accompanying text.
146. *Nordic Village*, 112 S. Ct at 1017. "Neither § 106(c) nor any other provision of law establishes an unequivocal textual waiver of the Government's immunity from a bankruptcy trustee's claims for monetary relief." *Id.*
147. Edelman v. Jordan, 415 U.S. 651, 664-67 (1974). At issue in *Edelman* was the retroactive payment of public aid benefits to correct delays in processing claims. The Court reasoned that such payments would reduce availability of future public funds:

> [W]here the state has a definable allocation to be used in the payment of public aid benefits, and pursues a certain course of action such as the processing of applications within certain time periods as did Illinois here, the subsequent ordering by a federal court of retroactive payments to correct delays in such processing

amount of devaluation of the mortgages. Thus, the *Edelman* portion of Eleventh Amendment doctrine should work to protect the state from this result of the application of the bankruptcy code.

The other analysis of this case concerns the source of power that creates the prospective relief for the debtors and how that power is used, not to protect but to encroach on the rights of the state. It is on this point that the court fails to discuss the important issues of federalism that arise when a congressional grant of power, made pursuant to the bankruptcy clause, does not act to shield a debtor but works a result prohibited by *Edelman*. Such a result may have a resounding effect on state supported financing programs which would only serve to diminish the availability of resources for a state's citizens to better their economic welfare.[148] In absence of the protection granted by the Eleventh Amendment, the citizenry deserves at least an explanation.

## IV. FOURTEENTH AMENDMENT — SUBSTANTIVE DUE PROCESS

In *Youngberg v. Romeo*,[149] the Supreme Court considered the substantive rights of involuntarily committed mentally retarded persons under the Fourteenth Amendment.[150] The Court, drawing from prior decisions,[151] held the involuntarily committed have a right to the established liberty interests of personal security and freedom from bodily restraint, as well as a right to such training related to safety and freedom from restraint of professionals who are charged with ensuring those rights.[152] In the more recent case of *DeShaney v. Winnebago County Department of Social Services*,[153] the Court addressed the question of whether a state is categorically obligated to protect a child who was taken into custody by a state agency then released to the natural father and suffers harm caused by the father. The Court answered this question in the negative. However, in a footnote, the Court suggested that where a state affirmatively exercises its power to remove the child from free society and place him in a foster home a sufficiently analogous situation to institutionalization may arise that may trigger application of *Youngberg*.[154] This footnote has created some confusion as to what factual situations may call for substantive due process protections. The Tenth Circuit Court of Appeals was faced with two different situations in

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will invariably mean there is less money available for payments for the continuing obligations of the public aid system.

*Id.* at 666 n.11.

148. *Id.*

149. 457 U.S. 307 (1982).

150. The Due Process Clause of the Fourteenth Amendment provides that no State shall "deprive any person of life, liberty, or property, without due process of law." U.S. CONST. amend. XIV.

151. *Youngberg*, 457 U.S. at 316-15 (citing Ingraham v. Wright, 430 U.S. 651 (1977) (right to personal security constitutes a historic liberty interest)); Greenholtz v. Nebraska Penal Inmates, 442 U.S. 1, 18 (1979) (liberty from bodily restraint recognized as a core liberty protected).

152. *Youngberg*, 457 U.S. at 322.

153. 489 U.S. 189 (1989).

154. *DeShaney*, 489 U.S. at 201 n.9.

*Yvonne L v. New Mexico Department of Human Services*[155] and *Maldonado v. Josey*[156] which required review to determine if they were sufficiently analogous to *Youngberg* to trigger due process protections.

A. *Tenth Circuit Cases*

1. *Yvonne L. v. New Mexico Dep't of Human Servs.*

The plaintiffs, Yvonne L., age 9, and Demond L., age 7, were in the physical and legal custody of the State of New Mexico Human Services Department (HSD) in August 1985 when they were placed in a not-for-profit foster care facility for children.[157] Yvonne was sexually assaulted in the presence of Demond by another child in an unsupervised area of this facility on August 16, 1985. Plaintiffs brought a § 1983 action against HSD[158] for alleged violations of their federal statutory[159] and constitutional rights while in foster care. The district court dismissed the constitutional claim under qualified immunity, finding that there was no clearly established constitutional right in August, 1985, protecting a child in the legal and physical custody of the state from bodily harm from third persons.[160] The plaintiffs appealed.

The court of appeals reversed.[161] In a unanimous opinion the court held that the law was sufficiently clear at the time of the incident to afford due process protections to those individuals in the physical custody of the state. The court cited the *DeShaney* footnote referring to cases holding due process protections existed in slightly different factual contexts.[162] Furthermore, the *Youngberg* decision established a state duty to assume responsibility for the safety and general well-being of a person taken into custody and held against their will by the state. The court cited opinions from three circuits[163] explicitly finding an right to reasonable safety while in foster care established prior to 1986. Finally, citing the Tenth Circuit decision of *Milonas v. Williams*, the court quoted its own language regarding a juvenile involuntarily placed in foster care: "Such a person has the right to reasonably safe conditions of confinement."[164]

The HSD asserted that the plaintiffs failed to show that HSD acted

155. 959 F.2d 883 (10th Cir. 1992) (before Logan, Seymour, and Moore, J.) (opinion by Logan, J.).

156. 975 F.2d 727 (10th Cir. 1992) (before Seymour, Tacha, and Benson, J.) (opinion by Tacha, J.) (Seymour, J., concurring), *cert. denied*, 61 U.S.L.W. 3581 (1993).

157. *Yvonne L.*, 959 F.2d at 885.

158. All defendants are referred throughout this survey as "HSD".

159. The statutory violations alleged were part of the Adoption Assistance and Child Welfare Act of 1980, 42 U.S.C. § 671 (1988).

160. *Yvonne L.*, 959 F.2d at 885. *See supra* note 12 and accompanying text for an explanation of qualified immunity.

161. *Yvonne L.*, 959 F.2d at 884.

162. *See supra* note 154 and cases cited therein.

163. *Yvonne L.*, 959 F.2d at 891 (citing Doe v. New York City Dep't of Social Serv's., 649 F.2d 134 (2d Cir. 1981), *cert. denied*, 464 U.S. 864 (1983)); Taylor ex rel. Walker v. Ledbetter, 818 F.2d 791 (11th Cir. 1987) (en banc), *cert. denied*, 489 U.S. 1065 (1989); K.H. ex rel. Murphy v. Morgan, 914 F.2d 846 (7th Cir. 1990).

164. 691 F.2d 931, 942 (10th Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983).

with "deliberate indifference," the standard applicable to their conduct.[165] Although the district court never addressed the standard to be applied, the court of appeals did so to provide guidance on remand.[166] The court elected to use the "failure to exercise professional judgment" standard enunciated in *Youngberg* noting that it is a higher standard than mere negligence, implying "abdication of the duty to act professionally in making the placement" to foster care.[167] To the extent that this standard differs from deliberate indifference, the court noted that foster children are entitled to more considerate treatment and conditions than criminals.[168]

2. *Maldonado v. Josey*

On March 16, 1987, Mark Maldonado was an eleven year-old fifth grade student attending a state-run school in Raton, New Mexico.[169] He became caught on his bandana in a cloakroom adjacent to his classroom and died of strangulation.[170] He had allegedly been in the cloakroom, unsupervised, for twenty minutes while Margaret Berry, his teacher and the person responsible for his supervision, conducted class in the classroom.[171] On August 7, 1990, Leroy Maldonado, as personal representative for Mark's estate, filed a § 1983 action for wrongful death.[172] The complaint asserted that the death occurred because of the deliberate indifference to training and supervision requirements by Berry and two school administrators.[173] The district court granted summary judgment finding that the plaintiff failed to show deliberate indifference on behalf of the administrators and that the law regarding a teacher's duty to observe every student in class during classtime was not clearly established.[174] The plaintiff appealed, challenging only the judgment with regard to the teacher.[175] The court of appeals affirmed.[176]

a. *Majority Opinion*

The court viewed the plaintiff's contention that a liberty interest and protection from deprivation of life without due process were implicated by the failure to provide reasonable care and safety for public

165. *Yvonne L.*, 959 F.2d at 893. The "deliberate indifference" standard articulated by the Supreme Court in *Estelle v. Gamble*, 429 U.S. 97 (1976), and applied to conduct alleged as a violation of the Eighth Amendment right against cruel and unusual punishment was applied in *Taylor*, 818 F.2d at 795-97, and *Doe*, 649 F.2d at 141-45.

166. *Id.*

167. *Id.* at 894.

168. *Id.* The court went on to state: "These are young children, taken by the state from their parents for reasons that generally are not the fault of the children themselves. The officials who place the children are acting in place of the parents." *Id.*

169. 975 F.2d 727, 728 (10th Cir. 1992).

170. *Id.*

171. *Id.*

172. *Id.* *See supra* note 8 for relevant language of 18 U.S.C. § 1983.

173. *Maldonado*, 975 F.2d at 728.

174. *Id.*

175. *Id.*

176. *Id.* at 733.

grade school children and by reckless indifference to supervision requirements in a public grade school, as an assertion of a categorical obligation to protect Mark Maldonado.[177] The assertion of a "categorical obligation" is analyzed under *DeShaney*.[178]

The court proceeded to set forth the *DeShaney* limitation of a state's obligation to protect an individual from harm caused by third persons and the limited situations where a duty has been found to exist.[179] In framing the issue to be decided on appeal, the court cited the *DeShaney* requirement that it is the "[s]tate's affirmative act of restraining the individual's freedom to act on his own behalf-through . . . institutionalization, or other similar restraint of personal liberty" which triggers due process protections.[180] Thus, the issue was whether state compulsory attendance laws restrain a school child's personal liberty such that due process imposes an obligation to protect that child.[181]

Cases involving extreme corporal punishment, or sexual abuse or harassment by a teacher were distinguished as inapplicable because those cases involve direct infliction of the harm by a state actor.[182] This case more closely resembles *DeShaney*, where the harm was inflicted by a private actor.[183] The court went on to distinguish a prior discussion of the relationship between the state and public school students made in the Tenth Circuit decision of *Hilliard v. City and County of Denver*.[184] The dictum concerning a schools duty of care in *Hilliard* was created in the context of bringing a due process claim under *Ingraham v. Wright*,[185] a corporal punishment claim involving a state actor and was therefore inapplicable to the present case.

The *Maldonado* court held that compulsory attendance laws in no way restrain a child's liberty so as to render a child and his parents unable to care for the child's basic needs, and therefore fail to trigger the

177. *Id.* at 729.

178. *Id.* It is unclear whether the court meant the substantive portion of the *DeShaney* opinion or footnote 9 which creates the possibility for finding a constitutional obligation. *See supra* note 154 and accompanying text.

179. *Maldonado*, 975 F.2d at 729.

180. *Id.* (citing DeShaney v. Winnebago City Social Servs. Dep't, 489 U.S 189, 200 (1989)).

181. *Maldonado*, 975 F.2d at 730.

182. *Id.* (citing Ingraham v. Wright, 430 U.S. 651 (1977); Stoneking v. Bradford Area School Dist., 882 F.2d 720 (3d Cir. 1989); Garcia v. Miera, 817 F.2d 650 (10th Cir. 1987), *cert. denied*, 485 U.S. 959 (1988)).

183. *Id.* at 731.

184. Hilliard v. City and County of Denver, 930 F.2d 1516 (10th Cir.), *cert. denied*, 112 S. Ct. 656 (1991). *Hilliard* addressed the duty of police officers to ensure the safety of those persons who are not in custody but are placed in a more dangerous position due to the actions of the officers. The exact language in *Hilliard* was:

> Public school students, although not restricted to the same degree as arrestees, convicts and patients involuntarily committed to state mental hospitals, are similarly involved in an environment where the state has some lawful control over their liberty. Students are required by state law to attend school and thus are prevented by the state from voluntarily withdrawing from situations posing the risk of personal injury.

*Id.* at 1520.

185. Ingraham v. Wright, 430 U.S. 651 (1977).

due process obligation to protect school children from harm.[186] The court noted with approval two courts of appeals decisions which came to the same conclusion.[187] These cases reasoned that incarceration and institutionalization involve full time severe and continuous restrictions of liberty. By contrast, school children reside in their parents' home, attend the schools of their parents' choice and the parents retain primary responsibility for meeting the child's basic human needs.[188] The court concluded by noting that parents remain the primary caretakers of the students, charged with determining and addressing the child's basic needs.[189] For these reasons, compulsory attendance laws do not impose restraints so severe as to implicate the Due Process Clause.[190]

b. *Concurring Opinion*

The concurring opinion noted that *Yvonne L.* held that the state owes children in its custody an affirmative duty of protection.[191] The *Maldonado* majority limits that duty by excluding schoolchildren. The concurrence advocated the imposition of a duty of some level of protection to school children because they are forced into temporary day-time custody of the state due to compulsory attendance laws.[192] However, since the plaintiff failed to show the deliberate indifference of the defendant to the danger of injury to Mark Maldonado, the concurrence would affirm summary judgment on qualified immunity grounds.[193]

The concurring opinion began with reviewing the Tenth Circuit's *Yvonne L.* analysis, noting the standard approved by that decision of "failure to exercise professional judgment" with respect to the danger.[194] The concurrence next distinguished cases cited by the majority in two ways. First, those cases involved repeated incidents that afforded a parent the opportunity to know of the danger and to take action.[195] Second, those cases failed to recognize that during the school day and class periods, parents are incapable of ensuring the reasonable safety of their children.[196] This obligation is better left to a teacher or other school staff members. The opinion went on to cite two cases that failed to follow the majority's reasoning because of the custodial relationship

186. *Maldonado*, 975 F.2d at 731.

187. D.R. v. Middle Bucks Area Vocational Technical Sch., Nos. 91-1136, 91-1137, 1992 WL 191115 (3d Cir. Aug. 11, 1992); J.O. v. Alton Community Unit Sch. Dist. 11, 909 F.2d 267 (7th Cir. 1990). *Middle Bucks* distinguished student care from foster care because foster care children depend on the state to meet their needs creating a continuing obligation, while school children are not so dependent. *Middle Bucks*, Nos. 91-1136, 91-1137, 1992 WL 191115 at **8.

188. *Maldonado*, 975 F.2d at 731-33.

189. *Id.* at 733.

190. *Id.*

191. *Id.* (Seymour, J., concurring).

192. *Id.*

193. *Id.*

194. *Id.* at 735; *see supra* note 167 and accompanying text.

195. *Maldonado*, 975 F.2d at 734-35. *Middle Bucks* involved repeated sexual assaults by students while *Alton* involved repeated sexual assaults by a teacher.

196. *Maldonado*, 975 F.2d at 735.

between teachers and students.[197] The concurrence concluded by stating that it would affirm the dismissal of the complaint for a failure to allege facts sufficient to show deliberate indifference or failure to exercise professional judgment by the teacher.[198]

B. *Analysis*

The different outcomes of *Yvonne L.* and *Maldonado* highlight divergent analyses of alleged substantive due process violations in the context of § 1983. The issue to be resolved is whether the imposition of a duty on the alleged tortfeasor may be based on some constitutionally supplied norm. In *Yvonne L.*, the court took the first step by applying the tort-based standard of *Canton v. Harris*.[199] This standard begins with requiring malfeasance, in that the defendants should have known that their actions in formulating a policy to provide for the physical safety of the children as well as their action in placing the children in foster care put the plaintiffs in personal danger.[200] The second requirement is that the defendant know that the placement would put the children in danger.[201] Finally, there must be a causal link between either action of the defendant and the injury. These elements must be met for the plaintiffs to be held liable for the deprivation of the recognized substantive due process interests in safe conditions, personal security and bodily injury for persons in state custody.[202]

The issue of duty in *Maldonado* involved a slightly different factual circumstance. The duty was to be imposed on the teacher, rather than the school administrators.[203] The issue of qualified immunity under *Harlow* was the same, whether the law regarding the existence of a duty

197. *Id.* (The concurrence cited Pagano v. Massapequa Public Schools, 714 F. Supp. 641 (E.D.N.Y. 1989) and Waechter v. School District No. 14-030, 773 F. Supp. 1005 (W.D.Mich. 1991)).

198. *Id.*

199. Canton v. Harris, 489 U.S. 378 (1989). The plaintiff is required to show three things: (1) that the defendant instituted a policy or training program; (2) the defendant knew of the asserted danger or failed to exercise professional judgment with respect to the danger; and (3) that there be a direct causal link between the policy or custom and the alleged constitutional deprivation. *Id.* at 385-90.

200. *Yvonne L. v. New Mexico Dep't of Human Servs.*, 959 F.2d 883, 890 (10th Cir. 1992) (In *Yvonne L.* there were two opportunities for the plaintiffs to show a violation under *Canton* since there were two affirmative acts that may have been causally linked to the injuries).

201. *Id.* at 890. This requirement has been characterized by some courts as "deliberate indifference" to the danger or more affirmatively by the U.S. Supreme Court as a failure to exercise professional judgment. Youngberg v. Romeo, 457 U.S. 307, 323 (1982). For an extensive critique of the Court's creation of differing standards see Charles F. Abernathy, *Section 1983 and Constitutional Torts*, 77 GEO. L.J. 1441, 1483-90 (1989).

202. It is unclear whether the interest in bodily integrity for persons in state custody is an existing constitutional right or whether the custody signifies the requirement of "state action" for purposes of a section 1983 action. *See supra* note 8.

203. Maldonado v. Josey, 975 F.2d 727, 728 (10th Cir. 1992). The district court found that the school administrators could not reasonably be said to have been "deliberately indifferent". *Id.* This standard is higher than the *Youngberg* standard adopted in *Yvonne L.* which requires a showing of "a substantial departure from accepted professional judgment, practice, or standards." *Youngberg*, 457 U.S. at 323. The differing standard notwithstanding, the appeal pertained only to the teacher's liability. *Maldonado*, 975 F.2d at 728.

was clearly established.[204] The court's analysis differed sharply from that in *Yvonne L.* Instead of analyzing whether the teacher owed a duty to supervise Maldonado within the *Youngberg* standard, the court premised its finding of "no duty" on the fact that the teacher did not inflict the injury rather than whether the teacher could have prevented the harm.[205] The duty to prevent harm is precisely the issue addressed in both *DeShaney* and *Youngberg*.

Applying the tort-based standard of *Canton* to *Maldonado*, the act which satisfies the first element is the requirement that students attend school through the state compulsory attendance law.[206] The court's analysis should have determined whether a duty could be imposed based on whether the actions of the teacher amounted to malfeasance, or nonfeasance given the supervisory capacity she held.[207] The court analyzed this point by citing cases that considered whether a "special relationship" existed between students and schools such that a duty may be imposed.[208] However, *Maldonado* is not a "special relationship" case. Compulsory attendance laws provide the duty. There are affirmative acts on the part of the defendant, one of which consists of providing a supervised and safe environment conducive to the education of children.[209] Although the law is clear after *DeShaney* and *Youngberg* regarding the existence of a duty when the state takes custody of a person, the court uses a strained definition of custody to obfuscate the law and fails to provide a standard for determining which forms of custody would give rise to a duty.

## V. CONCLUSION

During the survey period, the Tenth Circuit was faced with similar

204. *See supra* note 12 and accompanying text for an explanation of qualified immunity.

205. *Maldonado*, 975 F.2d at 731.

206. "Every child of school age and of sufficient physical and mental ability shall be required to attend a public or other school during such period and for such time as prescribed by law." N.M. CONST. art. XII, § 5.

207. Under *Youngberg*, malfeasance or nonfeasance is not the determining factor but whether either is a substantial departure from accepted professional judgment, practice, or standards. *Youngberg*, 457 U.S. at 323. In this case the teacher's inaction with knowledge that her student was absent from the classroom for twenty minutes would be analyzed using the *Youngberg* standard.

208. *See supra* note 187 and accompanying text. The Fifth Circuit case of Doe v. Taylor Indep. Sch. Dist., 975 F.2d 137 (5th Cir. 1992) found a duty to protect school children based on compulsory attendance laws and the fact that schoolchildren are dependent on their parents to guard against the dangers of their surroundings. "By removing a child from his home . . . the state obligates itself to shoulder the burden of protecting the child from foreseeable trauma." *Id.* at 146. This author would advocate a varying degree of duty commensurate with the age of the child and foreseeability of harm by the supervisor.

209. A public school "assumes a duty to protect [the schoolchildren] from dangers posed by anti-social activities . . . and to provide them with an environment in which education is possible." Horton v. Goose Creek Indep. Sch. Dist., 690 F.2d 470, 480 (5th Cir. 1982). The Supreme Court has recognized that schools "act" as parents to protect students from some harms. "[Prior] cases recognize the obvious concern on the part of parents, and school authorities acting *in loco parentis*, to protect children—especially in a captive audience—from exposure to sexually explicit, indecent, or lewd speech." Bethel Sch. Dist. No. 403 v. Fraser, 478 U.S. 675, 684 (1986). The audience was "captive" in a school assembly.

questions of individual rights under different factual circumstances. The cases surveyed do not give a clear indication of the direction the court will take in a particular factual scenario. However, the Tenth Circuit is slow to recognize the existence of constitutional duties or rights absent a showing that such duties or rights exist by decisions of other circuits. It is certain that the increasing use of Civil Rights laws to address violations of an individual's constitutional rights will continue to confront the court and the court will proceed with extreme caution.

*Peter Q. Murphy*

# CRIMINAL PROCEDURE SURVEY

## I. INTRODUCTION

In 1992, the Tenth Circuit challenged precedent in the areas of search and seizure and sentence enhancement. In an *en banc* opinion, *United States v. Abreu*,[1] the Tenth Circuit rejected the reasoning adhered to by six other circuits concerning the application of a sentence enhancement provision. In a panel decision, *United States v. Green*,[2] the Tenth Circuit reached the opposite result in applying a similar provision. In *United States v. Ward*,[3] the court refused to extend a Supreme Court ruling concerning the constitutionality of random bus searches to the setting of private train compartments.

This Survey examines the *Abreu* and *Green* opinions and the discrepancy between them. The Tenth Circuit's sentence enhancement doctrine is unclear because the two opinions cannot be reconciled. This Survey also analyzes the *Ward* opinion, which sets forth the Tenth Circuit's current search and seizure doctrine. An examination of the Tenth Circuit's independence in these areas defines current Tenth Circuit criminal procedure jurisprudence.

## II. APPLICABILITY OF SENTENCE ENHANCEMENT PROVISIONS

### A. *Background—United States v. Abreu*

Sentence enhancement involves the imposition of a greater sentence upon a defendant who has previously been convicted of criminal wrongdoing. It is a common feature of the federal and state criminal justice systems.[4] The Constitution permits sentence enhancement for a subsequent offense, contingent upon the validity of the prior conviction. The justifications for sentence enhancement include deterrence, incapacitation and the view that recidivists, or repeat offenders, are more culpable than first-time offenders.[5]

The sentence enhancement provision at issue in *Abreu* was 18 U.S.C. section 924(c).[6] Although described as a sentence enhancement provision in *Simpson v. United States*,[7] the Supreme Court held this statute creates an offense distinct from the underlying felony rather than merely

1. 962 F.2d 1447 (10th Cir. 1992) (*en banc*).
2. 967 F.2d 459 (10th Cir.), *cert. denied*, 113 S. Ct. 435 (1992).
3. 961 F.2d 1526 (10th Cir. 1992).
4. D. Brian King, Note, *Sentence Enhancement Based on Unconstitutional Prior Convictions*, 64 N.Y.U. L. REV. 1373, 1373 (1989).
5. *Id.* at 1373-74.
6. 18 U.S.C. § 924(c) (1988). Congress passed § 924(c), an amendment to the Gun Control Act of 1968, on October 22, 1968. The Gun Control Act of 1968 was part of the Omnibus Crime Control and Safe Streets Act. United States v. Rawlings, 821 F.2d 1543, 1545-46 n.6 (11th Cir.), *cert. denied*, 484 U.S. 979 (1987).
7. 435 U.S. 6, 10 (1978) (superseded by 1984 amendment to § 924(c)).

enhancing the sentence.[8] The second offense under section 924(c) is a distinct crime which carries a heavier penalty.[9]

Congress adopted this amendment following the assassinations of John and Robert Kennedy and Dr. Martin Luther King, Jr.[10] It provided an additional sentence of five years for anyone convicted of using a firearm in a crime of violence or drug trafficking offense.[11] In the event of a subsequent conviction under section 924(c), the statute provides an additional sentence of twenty years.[12] The sponsor of the amendment stated the purpose of this amendment was to persuade would-be felons to leave their guns at home.[13] Deterrence was of primary concern to the legislators. They stressed that a criminal who used a gun to commit a crime, and is convicted, will go to jail for a specific number of years. Courts did not have discretion in sentencing. For the deterrent to be effective, the criminal must know "he cannot beat the rap".[14]

In *Simpson v. United States*[15] and *Busic v. United States*,[16] the Supreme Court addressed whether Congress intended section 924(c) to apply when the predicate felony statute had its own enhancement provision. The Court held it did not; sentences could not be enhanced twice.[17] In response, Congress amended section 924(c) to clarify that it did authorize an enhanced sentence in addition to any enhancement provided by the underlying felony statute.[18]

In applying section 924(c), questions arose over the nature of the second offense required to trigger the 20-year enhancement provision. In *United States v. Rawlings*,[19] the defendant was convicted of two counts of bank robbery and of using a gun in connection with each count in

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8. *Id.* at 10.

9. Singer v. United States, 278 F. 415, 420 (3d Cir.), *cert. denied*, 258 U.S. 620 (1922).

10. *Rawlings*, 821 F.2d at 1545-46 n.6.

11. 18 U.S.C. § 924(c)(1) provides in pertinent part:

(c)(1) Whoever, during and in relation to any crime of violence or drug trafficking crime (including a crime of violence or drug trafficking crime which provides for an enhanced punishment if committed by the use of a deadly or dangerous weapon or device) for which he may be prosecuted in a court of the United States, uses or carries a firearm, shall, in addition to the punishment provided for such crime of violence or drug trafficking crime, be sentenced to imprisonment for five years . . . . *In the case of his second or subsequent conviction under this subsection, such person shall be sentenced to imprisonment for twenty years* . . . . (emphasis added).

12. *Id.*

13. "Any such person should understand that if he uses his gun and is caught and convicted, he is going to jail. He should further understand that if he does so a second time, he is going to jail for a longer time." 114 CONG. REC. 22,231 (daily ed. July 19, 1968)(statement of Rep. Poff). Representative Rogers agreed: "[A]ny person who commits a crime and uses a gun will know that he cannot get out of serving a penalty in jail. And if he does it a second time, there will be a stronger penalty." *Id.* at 22,237.

14. *Id.* at 22,243 (statement of Rep. Latta).

15. 435 U.S. 6 (1978).

16. 446 U.S. 398 (1980) (superseded by 1984 amendment to § 924(c)).

17. *Busic*, 446 U.S. at 404; *Simpson*, 435 U.S. at 16.

18. Congress affected this change by including within § 924(c) the parenthetical: "(including a crime of violence or drug trafficking crime which provides for an enhanced punishment if committed by the use of a deadly or dangerous weapon or device)." 18 U.S.C. § 924(c) (1988). *See* United States v. Lanzi, 933 F.2d 824, 826 (10th Cir. 1991).

19. 821 F.2d 1543 (11th Cir. 1987).

violation of section 924(c).[20] The district court held that the conviction of the second section 924(c) count triggered the enhanced penalty provision, regardless of the fact both counts were charged in the same indictment.[21] On appeal, Rawlings asserted that the statute required conviction and sentencing under two separate indictments before the enhanced penalty provision applied.[22]

The Eleventh Circuit, on rehearing *en banc*, relied on its independent reading to determine the statute's applicability.[23] Giving full effect to each provision of the statute, and assuming Congress used the words as they are commonly and ordinarily understood,[24] the court pointed out that the legislature chose to use the broad phrase "second or subsequent conviction."[25] Subsequent meant "following in time, order, or place," while second only meant "one more after the first."[26] The court concluded that a second conviction under section 924(c), "even though in the same indictment as his first conviction, legitimately triggers the enhancement provision."[27]

The *Rawlings* court noted that had Congress intended to narrow the provision, it could have done so explicitly.[28] The court cited the special offender statute[29] as an example. The statute defined a special offender as a person convicted of two or more offenses and imprisoned for at least one of those convictions within five years of the current offense.[30]

In contrast, in section 924(c) Congress included none of the restrictions of the special offender statute.[31] In addition, the defendant's arguments were inconsistent with the broad purpose of the provision. Congress intended to severely punish those who commit violent crimes with firearms. Prosecutors could satisfy the separate indictment requirement merely by charging offenses in separate indictments, "thereby ensuring that one of the convictions would occur later in time than the other."[32] The court concluded: "We do not think Congress intended the enhanced penalty for a repeat offender of section 924(c) to hinge on

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20. *Id.*
21. *Id.* at 1545.
22. *Id.* at 1546.
23. *Id.* at 1545.
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.* at 1546.
29. 18 U.S.C. § 3575(e) (1982) provides in pertinent part:
A defendant is a special offender for purposes of this section if — (1) the defendant has previously been convicted in courts of the United States . . . for two or more offenses committed on occasions different from one another and from such felony and punishable in such courts by death or imprisonment in excess of one year, *for one or more of such convictions the defendant has been imprisoned prior to the commission of such felony,* and less than five years have elapsed between the commission of such felony and either the defendant's release, on parole or otherwise, from imprisonment . . . . (emphasis added).
30. *Id.*
31. *Rawlings*, 821 F.2d at 1546.
32. *Id.*

the machinations of the prosecutor."[33]

Since the *Rawlings* decision, five other circuits[34] have adopted its reasoning and held that a second conviction under section 924(c), even though charged in the same indictment as the first, legitimately triggers the enhancement provision of section 924(c).[35] In *United States v. Abreu*,[36] the Tenth Circuit, on rehearing *en banc*, disagreed. Rather than phrasing the issue as whether section 924(c) required separate indictments, the court focused on whether the statute required that the offenses be separated by an intervening conviction. The court concluded that an enhanced sentence applies only when the underlying offense was committed *after* a judgment of conviction on the prior section 924(c) offense.[37]

### B. *Tenth Circuit Opinion*

#### 1. *United States v. Abreu*[38]

The prosecution charged Orestes Abreu in one indictment with drug and conspiracy offenses and four counts of using a firearm in connection with each offense in violation of section 924(c)(1).[39] Following conviction on all counts, the trial court sentenced Abreu on the drug and conspiracy charges and two of the section 924(c) charges.[40] The sentence for the second section 924(c) conviction was enhanced pursuant to the provisions of that statute.[41]

In a companion case, the prosecution charged James Thornbrugh in one indictment with three counts of bank robbery, with each robbery occurring on a separate date, and three section 924(c) counts, one for each of the alleged bank robbery offenses.[42] Thornbrugh was convicted of all the charges and received enhanced sentences for the second and third section 924(c) convictions.[43]

On appeal, both defendants questioned the propriety of their enhanced sentences under section 924(c). The Tenth Circuit ordered rehearing *en banc* to consider the lower court's interpretation of the enhancement provision of this statute.[44] In a 7-3 decision, the court found the text of the statute and legislative history to be ambiguous with

33. *Id.*
34. United States v. Bernier, 954 F.2d 818 (2d Cir.), *petition for cert. filed*, (June 29, 1992); United States v. Raynor, 939 F.2d 191 (4th Cir. 1991); United States v. Nabors, 901 F.2d 1351 (6th Cir.), *cert. denied*, 111 S. Ct. 192 (1990); United States v. Bennett, 908 F.2d 189 (7th Cir.), *cert. denied*, 111 S. Ct. 534 (1990); United States v. Foote, 898 F.2d 659 (8th Cir.), *cert. denied*, 111 S. Ct. 112 (1990).
35. *Rawlings*, 821 F.2d at 1545.
36. 962 F.2d 1447 (10th Cir. 1992).
37. *Id.* at 1453-54.
38. 962 F.2d 1447 (10th Cir. 1992).
39. *Id.* at 1448.
40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.*

respect to the intended definition of "second or subsequent conviction."[45] Hence, the court held that an enhanced sentence under section 924(c) for a second or subsequent conviction could not be imposed "unless the offense underlying this conviction took place after a judgment of conviction had been entered on the prior offense."[46] Accordingly, the court reversed the enhanced sentences and remanded the cases for resentencing.

a. *Majority Opinion*

Judge Seymour, writing for the majority, ruled that the phrase "second or subsequent conviction" was ambiguous because it was subject to more than one definition.[47] The majority found the legislative history ambiguous as well.[48] Statements made by Representatives, which referred to severe penalties for offenders who use guns and even more severe penalties for second offenders, did not compel a particular interpretation of "second or subsequent conviction."[49]

Given the ambiguity, the majority applied rules of statutory construction, specifically the rule of lenity.[50] The rule requires strict construction "to avoid and protect against unintended applications."[51] The Supreme Court in *Ladner v. United States*[52] stated that courts may not interpret statutes "so as to increase the penalty that it places on an individual when such an interpretation can be based on no more than a guess as to what Congress intended."[53]

The majority examined other enhancement provisions for guidance.[54] Many statutes require enhancement when a second offense is committed after a prior conviction.[55] In particular, the court pointed to 21 U.S.C. section 962(b), which states, "a person shall be considered convicted of a second or subsequent offense if, prior to the commission of such offense, one or more prior convictions of him for a felony . . . have become final."[56] The court noted the government failed to identify any federal enhancement statute that did not require a prior convic-

45. *Id.* at 1450.
46. *Id.* at 1453.
47. *Id.* at 1449-50.
48. *Id.* at 1450.
49. *Id.*
50. *Id.* at 1451.
51. *Id.* (citing Rogers v. United States, 325 F.2d 485, 487 (10th Cir. 1963), *rev'd on other grounds and remanded for resentencing*, 378 U.S. 549 (1964)).
52. 358 U.S. 169 (1958).
53. *Id.* at 178.
54. *Abreu*, 962 F.2d at 1451. In ascertaining congressional intent, the Supreme Court has indicated that reference to other statutes may be appropriate. *See, e.g.*, United States v. American Trucking Ass'ns, 310 U.S. 534, 534-44 (1940).
55. *See* 18 U.S.C. § 3575(e) (1982) (special offender statute); 21 U.S.C. §§ 841(b)(1) (commission of drug crime after prior drug conviction), 844(a) (simple possession of drugs after two or more prior convictions), 845(a) (engaging in continuing criminal enterprise after prior conviction), 859(b) (distributing drugs to minor after prior conviction), 860(b) (distributing or manufacturing drugs near a school after prior conviction), 861(c) (employing minors to violate drug laws after prior conviction) (1988 & Supp. III 1992).
56. 21 U.S.C. § 962(b) (1988).

tion before a sentence could be enhanced.[57]

The majority asserted that the government's interpretation of section 924(c) defeated the legislative purpose behind subsequent offense statutes.[58] "Reformation and retribution theories of punishment are the primary reasons for imposing greater penalties on the repeater."[59] Drafted as a deterrent, the statute made clear that a second offender, who apparently had not learned from the initial penalty, would receive more severe treatment.[60] The majority maintained that until the initial penalty has had an opportunity to effect the desired reformation, a subsequent offense statute may not be applied to that offender.[61] Therefore, as neither Abreu or Thornbrugh had the opportunity to learn from their mistakes, their sentences should not have been enhanced.

b. *Dissenting Opinion*

The dissent accused the majority of rewriting section 924(c) to include limitations not specified by Congress.[62] The dissent found the analysis employed by the other six circuits that addressed this issue persuasive.[63] The dissent argued that the plain meaning of the statute supported the conclusion that a second firearms conviction, even if charged in the same indictment, gave rise to an enhanced sentence.[64]

The dissent asserted that the majority's application of the rule of lenity was unwarranted.[65] A statute was not ambiguous "for purposes of lenity merely because it [is] possible to articulate a construction more narrow than that urged by the Government."[66] Six other circuits found the statute unambiguous.[67] The dissent pointed out that the rule of lenity is reserved "for those situations in which a reasonable doubt persists about a statute's intended scope."[68] Consequently, the majority placed premature emphasis on the rule of lenity as lenity applies only "at the end of the process of construing what Congress has expressed, not at the beginning as an overriding consideration of being lenient to wrongdoers."[69]

Finally, the dissent echoed the concern expressed by the other circuits over inefficient prosecution. Requiring the second or subsequent conviction to be the result of a separate indictment will do nothing more than require prosecutors to charge repeat offenders in separate indict-

57. *Abreu*, 962 F.2d at 1452.
58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.* at 1452-53.
62. *Id.* at 1454 (Brorby, J., dissenting) (Judges Tacha and Baldock joined Judge Brorby in dissent).
63. *Id.* at 1454-55.
64. *Id.*
65. *Id.* at 1455.
66. *Id.* (citing Moskal v. United States, 111 S. Ct. 461, 465 (1990)).
67. *Id.* at 1454. *See supra* note 33 and sources cited therein.
68. *Abreu*, 962 F.2d at 1455 (citing *Moskal*, 111 S.Ct. at 465).
69. *Id.* 962 F.2d at 1455 (citing Chapman v. United States, 111 S. Ct. 1919, 1926 (1991)).

ments.[70] Accordingly, the dissent maintained that the only legitimate interpretation of section 924(c) allowed a second or subsequent conviction charged in the same indictment as the first to trigger the enhancement provisions of that statute.[71]

Surprisingly, neither the *Abreu* majority nor dissent referred to *United States v. Tisdale* [72] or *United States v. Bolton*.[73] Those cases involved the interpretation of a similar sentence enhancement provision, in which the Tenth Circuit held intervening convictions were not a prerequisite to sentence enhancement.

### C. *Background*—U.S. v. Green

The sentence enhancement statute at issue in *United States v. Green*[74] was 18 U.S.C. section 924(e),[75] an amendment to the Armed Career Criminal Act (Career Criminal Act). The amendment provided that a convicted felon who possesses, receives or transports a firearm in interstate commerce may be fined up to $25,000 and shall be imprisoned not less than fifteen years.[76] Congress aimed the amendment at career criminals—for example, burglars and robbers who make up "one person crime waves."[77]

The original theory behind the amendment was that once the career criminal became a "three-time loser"—acquired three previous convictions—the only reasonable solution required permanent incarceration.[78] Subsequently, the length of the incarceration was changed to a 15-year minimum because the drafters recognized hypothetical circumstances wherein a life sentence might be extreme.[79]

The Career Criminal Act may be characterized as a recidivist statute because it imposes an increased sentence upon a repeat offender.[80] Recidivism is defined as "the reversion of an individual to criminal behavior after he or she has been convicted of a prior offense, sentenced, and (presumably) corrected."[81] The Second Circuit in *United States v. Ber-*

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70. *Id.* 962 F.2d at 1455.
71. *Id.*
72. 921 F.2d 1095 (10th Cir. 1990), *cert. denied*, 112 S. Ct. 596 (1991).
73. 905 F.2d 319 (10th Cir. 1990), *cert. denied*, 111 S. Ct. 683 (1991).
74. 967 F.2d 459 (10th Cir.), *cert. denied*, 113 S. Ct. 435 (1992).
75. 18 U.S.C. § 924(e) (1988). The predecessor statute, 18 U.S.C. § 1202(a), became § 924(e) as a result of the Firearms Owners' Protection Act in 1986.
76. 18 U.S.C. § 924(e)(1) provides in pertinent part:
> In the case of a person who violates section 922(g) of this title and has three previous convictions by any court referred to in section 922(g)(1) of this title for a violent felony or a serious drug offense, or both, committed on occasions different from one another, such person shall be fined not more than $25,000 and imprisoned not less than fifteen years . . . .

77. *United States v. Balascsak*, 873 F.2d 673, 681 (3d Cir. 1989).
78. *Id.* at 680.
79. *Id.*
80. *See* Jill C. Rafaloff, Note, *The Armed Career Criminal Act: Sentence Enhancement Statute or New Offense?*, 56 FORDHAM L. REVIEW 1085, 1094 (1988). Courts are split on this issue. Some characterize § 924(e) as an enhancement statute while others have held it creates a new federal offense. *Id.* at 1087 n.10.
81. King, *supra* note 4, at 1373 n.2.

*nier*[82] pointed to the specificity of the statute as proof that "when Congress intends to require prior convictions as a predicate for enhanced sentencing, it uses clear language to effectuate its intent."[83]

As the bill targeted "revolving door felons,"[84] the language of the statute has been read to require intervening convictions between the first and second conviction, as well as between the second and third before enhancement of the fourth conviction.[85] Legislative history supported this interpretation.[86] Despite the statute's wording and the legislative history, the Tenth Circuit, as well as six other circuits, interpreted the Career Criminal Act to require only that the multiple criminal episodes be distinct in time, not that the offenses be separated by intervening convictions.[87]

In *Abreu*, the Tenth Circuit defined a second or subsequent conviction in the enhancement statute context to mean "commission of a second offense after a prior conviction."[88] The Tenth Circuit, therefore, defined prior conviction as a conviction that is rendered prior to a subsequent offense.[89] Two months later, the Tenth Circuit, in a panel decision, handed down *United States v. Green*.[90] In *Green*, the court affirmed its holdings rendered in 1990 in *United States v. Bolton*[91] and *United States v. Tisdale*.[92] In those cases[93] the Tenth Circuit held that the Career

82. 954 F.2d 818 (2d Cir. 1992).

83. *Id.* at 820.

84. *Balascsak*, 873 F.2d at 682.

85. *Id.*

86. A statement made by Assistant Attorney General Stephen Trott supported the reading that intervening convictions are necessary to trigger sentence enhancement.

> These are people who have demonstrated, by virtue of their definition, that locking them up and letting them go doesn't do any good. They go on again, you lock them up, you let them go, it doesn't do any good, they are back for a third time. At that juncture we should say, "That's it; time out; it is all over. We, as responsible people, will never give you the opportunity to do this again."

*Armed Career Criminal Act: Hearing on H.R. 1627 and S.52 Before the Subcomm. on Crime of the House Comm. on the Judiciary*, 98th Cong., 2d Sess. 64 (1984).

87. *See* United States v. Hayes, 951 F.2d 707 (6th Cir. 1991), *cert. denied*, 112 S. Ct. 1694 (1992); United States v. Tisdale, 921 F.2d 1095 (10th Cir. 1990), *cert. denied*, 112 S. Ct. 596 (1991); United States v. Bolton, 905 F.2d 319 (10th Cir. 1990) *cert. denied*, 111 S. Ct. 683 (1991); United States v. Towne, 870 F.2d 880 (2d Cir.), *cert. denied*, 490 U.S. 1101 (1989); United States v. Herbert, 860 F.2d 620 (5th Cir. 1988), *cert. denied*, 490 U.S. 1070 (1989); United States v. Gillies, 851 F.2d 492 (1st Cir.), *cert. denied*, 488 U.S. 857 (1988); United States v. Wicks, 833 F.2d 192 (9th Cir. 1987), *cert. denied*, 488 U.S. 831 (1988); United States v. Greene, 810 F.2d 999 (11th Cir. 1986).

88. United States v. Abreu, 962 F.2d 1447, 1451 (10th Cir. 1992).

89. *Id.* at 1453.

90. 967 F.2d 459 (10th Cir. 1992).

91. 905 F.2d 319 (10th Cir. 1990).

92. 921 F.2d 1095 (10th Cir. 1990).

93. The facts of *Bolton* and *Tisdale* are nearly identical to *Green*. Bolton was convicted of four counts of armed robbery in a single judicial proceeding. Each robbery occurred at a separate time. Bolton appealed the enhancement of his sentence for a subsequent conviction of possession of a firearm by a former felon. *Bolton*, 905 F.2d at 319. Tisdale was convicted in a single judicial proceeding of three counts of burglary. Each burglary occurred at a separate time. Tisdale appealed the enhancement of his sentence for a subsequent conviction of possession of a firearm by a former felon. *Tisdale*, 921 F.2d at 1095. In both cases, the Tenth Circuit denied the appeals and affirmed this application of § 924(e)(1). *Tisdale*, 921 F.2d at 1101; *Bolton*, 905 F.2d at 324.

Criminal Act only required that felonies be "committed on occasions different from one another,"[94] and that it did not require that the offenses be separated by intervening convictions.[95]

D. *Tenth Circuit Opinion*

1. *United States v. Green*[96]

Two months after the *Abreu* decision, a Tenth Circuit panel, which included two of the three dissenting justices of *Abreu*, decided *Green*.[97] In *Green*, the Tenth Circuit panel affirmed its prior decisions that sentence enhancement under the Career Criminal Act was proper even when the requisite "three prior convictions" were the result of a single judicial proceeding. While *Abreu* and *Green* addressed separate provisions of section 924, both involved the definition of "prior conviction" for purposes of sentence enhancement with each arriving at different conclusions.

On July 26, 1979, in one judicial proceeding, Green was convicted of three armed robberies occurring on separate occasions.[98] On August 12, 1991, Green was convicted of possessing a firearm after a prior felony conviction.[99] The government filed a notice for an enhanced penalty pursuant to the provisions of the Career Criminal Act. Green urged the district court to find that the simultaneous convictions of July 26, 1979 did not meet the requirements of the Career Criminal Act.[100] The district court rejected Green's argument and consequently enhanced Green's sentence.[101]

On appeal, Green acknowledged that the Tenth Circuit recently held that the enhancement provision of the Career Criminal Act could be triggered even if the three prior convictions were the result of a single judicial proceeding,[102] but sought reconsideration in light of *United States v. Balascsak*.[103] In *Balascsak*, the Third Circuit held 18 U.S.C. section 1202(a), the predecessor statute to the Career Criminal Act, required that the first conviction must have been rendered prior to the commission of the second crime.[104] However, the deciding vote in *Balascsak* concurred in the result, yet agreed with the dissent's analysis of section 1202(a).[105] The *Balascsak* dissent argued that Congress in-

94. *Green*, 967 F.2d at 461.
95. *Id.*
96. 967 F.2d 459 (10th Cir. 1992).
97. Justices Tacha and Baldock joined Justice Brorby in dissent in *Abreu*. *Abreu*, 962 F.2d at 1454. Justice Joseph T. Sneed, Circuit Justice for the United States Courts of Appeals for the Ninth Circuit, sitting by designation, joined in the opinion with Justices Tacha and Brorby in *Green*. *Green*, 967 F.2d at 460.
98. *Id.* at 460.
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. 873 F.2d 673 (3d Cir. 1989)(en banc), *cert. denied*, 111 S. Ct. 173 (1990).
104. *Id.* at 682.
105. *Id.* at 684-85 (Becker, J., concurring).

tended section 1202(a) to apply when the convictions arose from separate criminal episodes regardless of the date of the convictions.[106] Because the majority and dissent each received six votes, the precedential authority of *Balascsak* was unclear.

The Third Circuit resolved this ambiguity in *United States v. Schoolcraft*,[107] which held that the Career Criminal Act did not require the separation of the three predicate offenses by intervening convictions, but rather that the criminal episodes be distinct in time.[108] This multiple episodes approach has been adopted by every federal court of appeals that has considered this issue.[109]

The *Green* court found the reasoning of *Schoolcraft* persuasive, in addition to the wording of the Career Criminal Act. Because the statute "only requires that the felonies be 'committed on occasions different from one another,' "[110] it was clear that it did not require that the offenses be separated by intervening convictions. Accordingly, the court found the enhancement of Green's sentence under the Career Criminal Act proper.[111] The *Green* panel did not mention its recent *Abreu* decision.

### E. *Analysis*

The discrepancy between *Abreu* and *Green* warrants examination. In both cases appropriate application of enhancement provisions was at issue. The Tenth Circuit determined whether Congress drafted these statutes primarily for their deterrent effect to discourage criminals from committing multiple crimes, regardless of prior convictions, or whether the statutes solely targeted those who fail to reform after an initial conviction. If inherent in the concept of "enhancement" is the notion of "second time through the system," then no additional statutory mention of such intent is necessary, as suggested by the *Abreu* majority. Congress offered and passed section 924(c) on the same day, hence, congressional reports and committee reports do not exist.[112] Consequently, the court must resort to the "sparse pages of the floor debate"[113] to interpret legislative intent. Absence of language in these pages of opportunity to reform can hardly be conclusive. In contrast, Congress did not offer and pass the Career Criminal Act in one day. Congressional and committee reports do exist offering more insight into the drafters' intent. The legislative history behind the Career Criminal Act consistently referred to "repeat offenders," "revolving door" offenders and "inability to rehabilitate."[114]

106. *Id.* at 685 (Greenberg, J., dissenting).
107. 879 F.2d 64 (3d Cir. 1989).
108. *Id.* at 73.
109. United States v. Towne, 870 F.2d 880, 889-90 (2d Cir. 1989) (citing cases).
110. United States v. Green, 967 F.2d 459, 461 (10th Cir. 1992) (citing § 924(e)(1)).
111. *Id.* at 462.
112. United States v. Abreu, 962 F.2d 1447, 1450 (10th Cir. 1992).
113. *Id.*
114. United States v. Balascsak, 873 F.2d 673, 682 (3d Cir. 1989).

In construing statutes, words not specifically defined will be interpreted as having their ordinary, common meaning.[115] Courts are not devoid of their common sense when interpreting legislative intent. Although section 924(c) is headed "Penalties," courts describe it as an enhancement provision.[116] Webster's Dictionary defines "enhance" as to "raise," "to make greater," or to "heighten."[117] Common sense dictates that enhancement attaches to the sentence for a crime committed *after* a previous conviction for a previous crime committed at a previous time.

However, a fine line exists between a court employing its common sense and a court interjecting terms it perceives as necessary to effectuate statutes.[118] For example, the *Abreu* majority relied on the specific language of other sentence enhancement statutes to assert that if limitations were included there, so too must Congress have intended them to apply to section 924(c).[119] This logic of inferring from parts of various enhancement statutes to the whole of every enhancement statute strips the legislature of its decision-making authority. Such logic also assumes Congress acted carelessly in the drafting of section 924(c) and inadvertently left out not merely one word, but full sentences which would significantly narrow the statute's scope. While the court "should strive to interpret a statute in a way that will avoid an unconstitutional construction,"[120] the court is not given a license to "rewrite language enacted by the legislature."[121]

Therefore, the court must exercise caution in asserting its common sense. "[I]n our constitutional system the commitment to the separation of powers is too fundamental for us to pre-empt congressional action by judicially decreeing what accords with 'common sense and the public weal.' "[122] Courts should not speculate, much less act, on whether Congress would have altered its stance,[123] had particular situations been anticipated, because "[i]f corrective action is needed, it is the Congress that must provide it."[124]

The divergent circuit opinions exist due to imprecise and inconsistent statutory drafting by the legislature. To assert, however, that the legislature chose words in one statute and therefore deliberately left those words out of a similar statute is to assume the same legislature drafted each statute. Congress does not refer to a lexicon of statutory language. Use of certain words is not mandatory to convey certain

115. Perrin v. United States, 444 U.S. 37, 42 (1979).
116. *Abreu*, 963 F.2d at 1448; United States v. Rawlings, 821 F.2d 1543, 1544 (11th Cir. 1987).
117. WEBSTER'S NEW COLLEGIATE DICTIONARY 375 (1981).
118. United States v. Raynor, 939 F.2d 191, 193 (4th Cir. 1991).
119. *Abreu*, 963 F.2d at 1451-52.
120. Chapman v. United States, 111 S. Ct. 1919, 1927 (1991).
121. *Id.*
122. Busic v. United States, 446 U.S. 398, 410 (1980) (citing TVA v. Hill, 437 U.S. 153, 195 (1978)).
123. *Id.* at 405.
124. *Id.*

meanings. Rather, the wording of a statute hinges on the personalties of its sponsors, purposes of the legislation, time allowed for debate, revisions and amendments. Consequently, statutes enacted to effect the same result may possess little uniformity.

Because of inept drafting, the courts of this country face the dilemma of either adhering to a strict construction approach or using their judgment and common sense. A strict construction approach risks illogical and unjust results in an effort to keep the doctrine of separation of powers intact. A common sense approach may result in the nonliteral interpretation of the language used by the legislature, thereby risking erosion of the separation of powers. Congress's failure to clearly announce its intent results in courts balancing this equation.

The pursuit of that balance engaged these circuits in their attempts to interpret the applicability of enhancement provisions. Not only do there exist opposing views between circuits as to which approach should be adopted, but within circuits as well. The *Abreu* majority employed common sense and judicial discretion while the *Abreu* dissent and the *Green* court adhered to a strict and putatively literal statutory construction approach. A better approach would require courts to enforce the laws as written and resort to a common sense interpretation only when clearly necessary, for example, when failure to do so would yield absurd or illogical results.

However, it appears the Supreme Court will not decide which of these approaches was correct. A petition for certiorari was denied in *Green* on November 2, 1992.[125] A petition for certiorari was filed in *Abreu* on July 9, 1992. The petition has not been granted or denied.[126] Rather, the Supreme Court granted certiorari in an identical case, *United States v. Deal*,[127] on due process grounds rather than based upon statutory construction, and presumably will dispose of *Abreu* upon resolution of *Deal*.[128] On October 21, 1992, the Federal Public Defender's Office filed a supplemental memorandum in hopes of consolidating *Abreu* with *Deal*.[129]

125. 113 S. Ct. 435 (1992).

126. The Supreme Court denied a petition for certiorari as to Thornbrugh's convictions. United States v. Thornbrugh, No. 92-5053, 1992 WL 171156 (U.S. Oct 5, 1992).

127. 954 F.2d 262 (5th Cir.), *cert. granted*, 113 S. Ct. (1992). Deal was charged and convicted in a single judicial proceeding of six counts of bank robbery, six violations of § 924(c) and one violation of § 922(g). *Id.* The trial court held the six separate convictions of § 924(c) triggered the enhancement provisions of that section, thereby resulting in a consecutive sentence amounting to 105 years. *Id.* The Fifth Circuit affirmed, holding that the second or subsequent conviction language provided for enhanced penalties for a crime of violence even if charged in the same indictment as the first. *Id.* at 263.

128. Telephone interview with Vicki Mandell-King, Asst. Federal Public Defender for the Districts of Colorado and Wyoming (Nov. 18, 1992).

129. *Id.* The supplemental memorandum was filed pursuant to Sup. Ct. R. 15.7, 28 U.S.C.A. § 15.7 (Supp. 1992).

## III. TESTING THE SCOPE OF *BOSTICK* AS APPLIED TO POLICE-PASSENGER ENCOUNTERS ON TRAINS

### A. *Background*

Discussion concerning the constitutionality of police field interrogation — police authority to stop, question, and frisk suspicious persons who cannot be arrested — first appeared in 1960.[130] The Supreme Court issued landmark opinions on police field interrogation in *Terry v. Ohio*,[131] and *Sibron v. New York*.[132] At the time these cases were decided, the exclusionary rule[133] was the most frequently invoked remedy to control and limit police activities.[134] Once the Supreme Court applied the exclusionary rule to the states in 1961,[135] it became important to more precisely define what constituted a seizure that required probable cause.

The *Terry* Court recognized that not all interaction between police officers and citizens involved seizures. "Only when the officer, by means of physical force or show of authority, has in some way restrained the liberty of a citizen may we conclude that a 'seizure' has occurred."[136] In *Terry* and its companion cases, the Supreme Court attempted to further define acceptable police practices[137] by categorizing police-citizen encounters as falling into one of three types: (1) voluntary encounters—"nonseizures," which require no evidentiary predicate at all, and therefore, do not implicate the Fourth Amendment; (2) investigative deten-

130. Frank J. Remington, *The Law Relating to "On the Street" Detention, Questioning and Frisking of Suspected Persons and Police Arrest Privileges in General*, 51 J. CRIM. L., CRIMINOLOGY & POLICE SCIENCE 386 (1960).

131. 392 U.S. 1 (1968).

132. 392 U.S. 40 (1968). *Sibron* was a consolidation of two cases, the other being Peters v. New York.

133. Weeks v. United States, 232 U.S. 383 (1914), *overruled by*, Elkins v. United States, 364 U.S. 206 (1960) *on other grounds*.

134. However, its function was, and still is, limited. Courts only invoke the exclusionary rule 1) if the illegally obtained evidence is needed for conviction; and 2) if an appropriate motion is made at the appropriate time. The state may indirectly use illegally obtained evidence, for example, for impeachment purposes. A major flaw of the exclusionary rule is that it is geared solely toward conviction and fails to account for the fact that police illegality is still utilized in the bargaining process. Lawrence P. Tiffany, *The Fourth Amendment and Police-Citizen Confrontations*, 60 J. CRIM L., CRIMINOLOGY & POLICE SCIENCE 442, 452 (1969).

135. The Supreme Court extended the exclusionary rule to the state courts in Mapp v. Ohio, 367 U.S. 643 (1961).

136. *Terry*, 392 U.S. at 19 n.16.

137. Edwin J. Butterfoss, *Bright Line Seizures: The Need for Clarity in Determining When Fourth Amendment Activity Begins*, 79 J. CRIM. L. & CRIMINOLOGY 437 (1988). *Terry* was not the first occasion the Supreme Court had to address this question. In Rios v. United States, 364 U.S. 253 (1960), the Court had to determine the legality of a seizure. Two police officers approached a cab stopped at a light driven by Rios. *Id.* at 256. The issue was whether an arrest occurred when the officers took their positions at the doors of the cab, which would have been illegal; or whether the arrest took place after one of the officers saw the defendant drop what turned out to be narcotics to the floor of the cab. *Id.* at 262. The Court remanded the case to the trial court to determine when the arrest occurred, but provided no significant guidelines, nor addressed the question of whether police officers may properly detain individuals for questioning without reasonable suspicion. *Id.* at 262. The state court avoided these issues as well, determining that the officers' actions were justified as part of routine interrogation. Rios v United States, 192 F. Supp. 888, (S.D. Cal. 1961).

tions — seizures which must be supported by reasonable suspicion, an evidentiary requirement less than probable cause; and (3) arrests, which must be supported by probable cause.[138]

Analyzing search and seizure cases with three questions in mind proves helpful. The first question asks whether the police seized the suspect, and if so, whether the seizure occurred lawfully. The second question asks whether the search occurred lawfully. The third question addresses consent. The only circumstance under which evidence obtained from an unlawful search may be admissible is if the suspect voluntarily consented to the search of his person or belongings. In order for consent to be voluntary, it must be sufficiently attenuated from any illegal detention.[139] Answers to these questions can only be derived from an examination of the totality of the circumstances of each case.

In *Terry*, a police officer observed Terry and another man, Chilton, repeatedly walking back and forth in front of a store window.[140] The officer, suspecting the men of "casing a job, a stick-up," confronted the men. The officer frisked Terry and found a gun. Defense counsel moved to suppress the weapon. In an 8-1 decision,[141] the Court affirmed the denial of the motion to suppress. The Court held the officer had reasonable grounds to support his belief that the two men acted suspiciously and that they might be armed, thereby justifying the pat-down search.[142]

The Court drew a distinction between an investigatory stop and an arrest. An arrest required probable cause to believe a crime had been committed and that the suspect committed it. An investigatory stop required "specific and articulable facts which, taken together with rational inferences from those facts, reasonably warrant that intrusion."[143] The Court also distinguished between a "frisk" and a full-blown search. The Court held an officer may frisk a suspect for dangerous weapons if the officer has evidence that reasonably lead him to believe that the suspect is armed and dangerous.[144] In contrast, a full-blown search is justified only by probable cause.

Because the officer physically seized Terry almost immediately, the Court did not need to address at what point a seizure took place.[145] The scope of *Terry* was narrow. It held only that when an officer investigates a suspicious person, the officer may frisk that person for danger-

138. *See* United States v. Cooper, 733 F.2d 1360, 1363 (10th Cir.), *cert. denied*, 467 U.S. 1255 (1984).

139. United States v. Turner, 928 F.2d 956, 958 (10th Cir.), *cert. denied*, 112 S. Ct. 230 (1991). In 1975, the Supreme Court identified the factors to consider in determining whether voluntary consent exists. A reviewing court must look at 1) the closeness in time between the illegal detention and the "consent;" 2) the existence of intervening circumstances; and 3) "the purpose and flagrancy of the official misconduct." Brown v. Illinois, 422 U.S. 590, 603-04 (1975).

140. Terry v. Ohio, 392 U.S. 1, 5-6 (1968).

141. *Id.* (Justice Douglas dissented).

142. *Id.* at 30-31.

143. *Id.* at 21 (footnote omitted).

144. *Id.* at 30.

145. Butterfoss, *supra* note 135, at 437 n.4.

ous weapons if the officer has evidence that reasonably leads him to believe that the suspect is armed and dangerous.[146] Consequently, the *Terry* Court left undefined the precise contours of an arrest, a non-seizure and an investigatory detention.

The scope of *Sibron*[147] was equally narrow. In *Sibron,* a police officer observed defendant Sibron over an eight-hour period in conversation with people known to the officer as narcotic addicts.[148] The officer observed Sibron speaking with three more known addicts that evening inside a restaurant.[149] The officer approached him and told him to come outside. Outside, the officer said to Sibron, "You know what I am after."[150] The officer testified Sibron "mumbled something and reached into his pocket."[151] Simultaneously, the officer thrust his hand into the same pocket and discovered several glassine envelopes, which were later determined to contain heroin.[152] The trial court held the officer had probable cause to arrest Sibron.[153] Accordingly, it held that the search was properly incident to that arrest.[154] The New York Court of Appeals affirmed without opinion.[155]

The Supreme Court, in five opinions,[156] reversed Sibron's conviction. Chief Justice Warren, writing the majority, defined the frisk of Sibron as the intrusion that had to be justified as the record was unclear whether Sibron had been seized prior to the search.[157] The Court found no elements of a self-protective search and therefore, concluded that the intrusion was unconstitutional.[158]

In *Terry* and *Sibron* the Court refused to address the issue of whether the initial confrontations involved restraint. In *Terry*, the Court stated: "We thus decide nothing today concerning the constitutional propriety of an investigative 'seizure' upon less than probable cause for purposes of 'detention' and/or interrogation."[159] Similarly, in *Sibron* the Court stated: "We are not called upon to decide in this case whether there was a 'seizure' of Sibron inside the restaurant antecedent to the physical seizure which accompanied the search."[160] The Court acknowledged it

146. *Terry*, 392 U.S. at 30.
147. Sibron v. New York, 392 U.S. 40 (1968).
148. *Id.* at 45.
149. *Id.*
150. *Id.*
151. *Id.*
152. *Id.*
153. *Id.* at 47.
154. *Id.*
155. *Id.*
156. Justices Brennan, White, Stewart and Marshall concurred with Chief Justice Warren's majority opinion. *Sibron,* 392 U.S. at 40. Justice Douglas, in a separate opinion, seemed to agree with the approach of the majority. *Id.* at 68. Justice Harlan reiterated the analysis he advocated in *Terry*. *Id.* at 70. Justice Fortas would have given more weight to the confession of error. *Id.* at 70. Finally, Justice Black dissented on the ground that the police action was taken in reasonable self-defense. *Id.* at 70, 79.
157. *Id.* at 60 n.20.
158. *Id.* at 66-67.
159. *Terry*, 392 U.S. at 19 n.16.
160. *Sibron,* 392 U.S. at 63.

is not necessary for a suspect to be taken to the station house before a seizure has occurred, however, it gave no guidelines for determining when a seizure has taken place, outside the undefined "show of authority."[161]

In the decade following *Terry*, courts focused on clarifying the definition of "investigatory detentions." Not until the early 1980s did the "nonseizure" category—supposed "voluntary encounters"—the focus of this analysis, receive further scrutiny.[162]

The two cases which gave rise to the test currently employed by courts to determine whether a police-citizen encounter constituted a "nonseizure" are *United States v. Mendenhall*[163] and *Florida v. Royer*.[164] In *Mendenhall*, Drug Enforcement agents believed Mendenhall's behavior in the Detroit Metropolitan Airport was characteristic of a drug trafficker. The agents approached her, identified themselves and asked to see her driver's license and airline ticket.[165] After discovering a discrepancy between the names listed on the two items and observing Mendenhall's increased nervousness, the agents asked Mendenhall to accompany them to the DEA office for further questions.[166] There, Mendenhall agreed to a search of her person and handbag despite being told she could refuse such a search. The search resulted in the discovery of heroin and the agents arrested Mendenhall.[167]

Justice Stewart, writing for the plurality, focused on whether Mendenhall had been seized when approached by the agents and asked questions.[168] In answering this question, Justice Stewart followed the view expressed in *Terry* that a person is "seized" only when his freedom of movement is restrained by means of physical force or a show of authority.[169] Thus, Justice Stewart held "that a person has been 'seized' within the meaning of the Fourth Amendment only if, in view of all the circumstances surrounding the incident, a reasonable person would have believed that he was not free to leave."[170] Justice Stewart concluded that "nothing in the record suggests that the respondent had any objective reason to believe that she was not free to end the conversation in the concourse and proceed on her way, and for that reason we conclude that the agents' initial approach to her was not a seizure."[171]

Justice Powell concurred with the result, but found that a seizure based on reasonable suspicion occurred.[172] While he did not disagree with the "walk away" standard put forth by Justice Stewart, he felt it was

161. *Terry*, 392 U.S. at 19 n.16.
162. Butterfoss, *supra* note 135, at 437-38.
163. 446 U.S. 544 (1980).
164. 460 U.S. 491 (1983).
165. *Mendenhall*, 446 U.S. at 547-48.
166. *Id.* at 548.
167. *Id.* at 549.
168. *Id.* at 551-52.
169. *Id.* at 553.
170. *Id.* at 554.
171. *Id.*
172. *Id.* at 560 (Powell, J., concurring).

a close call as to whether Mendenhall was free to walk away.[173] Justice White, dissenting, assumed as well a seizure occurred, and disagreed with the standard suggested by Stewart.[174] The three differing views in the *Mendenhall* opinion created uncertainty among lower courts as to the standard for determining whether a seizure took place.[175] Three years later, the Supreme Court addressed this uncertainty in *Florida v. Royer*.[176]

In *Royer*, Justice White, writing for the four justice plurality, adhered to the "free to leave" test of *Mendenhall*.[177] Yet, the Court reached the opposite result with facts virtually identical to *Mendenhall*. Royer, like Mendenhall, fit a drug courier profile.[178] Royer produced a driver's license and airline ticket bearing different names, and became noticeably more nervous as the conversation with the government agents progressed.[179] The agents did not return Royer's license or ticket, but asked him to accompany them to a flight attendant's lounge.[180] Royer's luggage was brought to the room without Royer's consent. When requested, Royer produced a key to one suitcase and allowed the officers to pry open the other suitcase. The agents found marijuana and arrested Royer.[181]

The court ruled the search of the luggage was unlawful because at that time, Royer "as a practical matter" was under arrest[182] and probable cause did not exist to justify such an arrest.[183] Paramount to this determination was the fact the agents retained Royer's ticket and driver's license without indicating in any way he was free to depart.[184] While tenuous to hinge the different outcomes of *Mendenhall* and *Royer* on whether identification was returned, this one fact further supported the Court's "free to leave" analysis.[185]

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173. *Id.* at n.1.

174. *Id.* at 569-71 (White, J., dissenting).

175. Butterfoss, *supra* note 135, at 447.

176. 460 U.S. 491 (1983).

177. *Id.* at 503-04 n.9.

178. *Id.* at 493.

179. *Id.* at 494.

180. *Id.*

181. *Id.* at 494-95.

182. *Id.* at 501.

183. *Id.* at 507.

184. *Id.* at 503-04 n.9.

185. The next Supreme Court decision that addressed the issue of when a seizure occurs was I.N.S. v. Delgado, 466 U.S. 210 (1984). In that case, the practice of immigration officers in conducting surveys of factories in search of illegal aliens was challenged. Agents approached employees, asked questions and, in some cases, requested immigration papers. The Ninth Circuit applied the *Mendenhall* test to conclude that the entire work force had been seized because a reasonable worker "would have believed he was not free to leave." The Supreme Court reversed, citing the language of *Royer* that "interrogation relating to one's identity or a request for identification by the police does not, by itself, constitute a Fourth Amendment seizure." The Court felt the employees could not have possessed a reasonable fear that they were not free to continue working or move about the factory. *Delgado*, with its unusual setting of a factory, added little in the way of clarification to the murky doctrine of "nonseizures." *Id.*

In 1991, the Supreme Court in *Florida v. Bostick*[186] interpreted the *Mendenhall-Royer* "free to leave" test to include the concept of "free to terminate the encounter."[187] At issue in that case was the constitutionality of random bus searches. In an effort to curtail drug traffic, Broward County Sheriff's Department officers routinely boarded buses and, without articulable suspicion, asked passengers for permission to search their luggage.[188] Bostick, after being advised of his right to refuse, consented to such a search. After finding cocaine, the officers arrested Bostick.[189] The trial court denied his motion to suppress the cocaine. The Florida Court of Appeals affirmed, but certified a question to the Florida Supreme Court concerning the constitutionality of such random bus searches.[190]

The Florida Supreme Court, citing the *Mendenhall-Royer* test, held that a reasonable passenger would not feel free to leave the bus to avoid questioning by the police, and adopted a *per se* rule that such "working the buses" was unconstitutional.[191] The Supreme Court granted certiorari to determine whether this *per se* rule is consistent with the Fourth Amendment.

The Supreme Court held the "free to leave" analysis inapplicable to the setting of a bus because Bostick's freedom of movement was restricted not because of police conduct, but because he chose to be a passenger on a bus.[192] Consequently, the appropriate inquiry "is whether a reasonable person would feel free to decline the officers' requests or otherwise terminate the encounter."[193] At issue then, was whether such a police-citizen encounter on a bus constituted an investigatory detention first identified in *Terry*.

The Court recognized that a seizure does not occur merely because a police officer approaches an individual and asks a few questions. Such an encounter does not trigger Fourth Amendment protection unless it loses its consensual nature.[194] In addition, police officers may request consent to search luggage as long as they do not convey the message that compliance with their request is mandatory.[195]

The Court pointed out that the trial court did not evaluate all the circumstances surrounding the encounter to determine whether a seizure occurred, but rather based its finding solely on the fact the encounter took place on a bus.[196] The location of the encounter is one factor for consideration, but the trial court erred in making it the only

186. 111 S. Ct. 2382 (1991).
187. *Id.* at 2387.
188. *Id.* at 2384.
189. *Id.* at 2384-85.
190. *Id.* at 2385.
191. *Id.*
192. *Id.* at 2387.
193. *Id.*
194. *Id.* at 2386.
195. *Id.*
196. *Id.* at 2388.

relevant factor.[197] Accordingly, the Supreme Court remanded so the Florida court could properly evaluate the seizure question.[198]

The *Bostick* dissent took issue with the majority's authorization of police questioning of citizens without particularized suspicion, which it viewed as a violation of the core values of the Fourth Amendment.[199] Judge Marshall, speaking for the dissent, characterized such "random indiscriminate stopping and questioning of individuals"[200] as "inconvenient, intrusive, and intimidating."[201] The dissent argued if the Court allowed these types of confrontations, so too will it allow "random knocks on the doors of our citizens' homes seeking 'consent' to search for drugs."[202] The dissent agreed with the majority's test, but failed to understand how Bostick could have felt free to decline the officers' requests.[203]

The dissent argued Bostick had no reasonable alternative to cooperating with the officers.[204] Had Bostick refused to answer questions, he would have aroused the officers' suspicions. In addition, leaving the bus at an intermediate point in a long bus journey[205] and abandoning his belongings in the process was not a feasible option.[206] The dissent concluded by emphasizing police may approach passengers whom they have reason to suspect of criminal wrongdoing.[207] In addition, police may confront passengers without suspicion "so long as they took simple steps, like advising the passengers confronted of their right to decline to be questioned, to dispel the aura of coercion and intimidation that pervades such encounters."[208] As the encounter with Bostick did not fall within one of these two acceptable categories, the dissent found the encounter illegal.

### B. *Tenth Circuit Opinion*

#### 1. *United States v. Ward*[209]

##### a. *Background*

In *Ward,* the Albuquerque Police Department received information concerning an Amtrack train passenger, Ward. The information re-

197. *Id.* at 2389.

198. On remand, the Florida Supreme Court found that defendant's consent to search his luggage was voluntary, and affirmed the conviction. Bostick v. State, 593 So. 2d 494 (Fla. 1992).

199. *Bostick*, 111 S. Ct. at 2389 (Marshall, J., dissenting). Justices Blackmun and Stevens joined Justice Marshall in dissent. *Id.*

200. *Id.* at 2391 (quoting United States v. Lewis, 728 F. Supp. 784, 788-89 (D.D.C.), *rev'd*, 921 F.2d 1294 (D.C. Cir. 1990)).

201. *Id.* at 2390 (quoting United States v. Chandler, 744 F. Supp. 333, 335 (D.D.C. 1990)).

202. *Id.* at 2391 (quoting *Lewis*, 728 F. Supp. at 788-89).

203. *Id.*

204. *Id.* at 2392-94.

205. *Id.* at 2393.

206. *Id.* at 2393-94.

207. *Id.* at 2394.

208. *Id.* at 2394-95.

209. 961 F.2d 1526 (10th Cir. 1992).

vealed that the passenger had paid $600 in cash for a one-way ticket from Flagstaff, Arizona to Kansas City, Missouri; the call-back number given by the passenger originated in Tucson, a known drug origination point; and that the passenger reserved the largest private room on the train.[210] Detective Erekson and Agent Small met the train when it arrived in Albuquerque. The officers boarded the train and knocked on the door to the train sleeper car occupied by Ward. Ward opened the door and the detective leaned inside the compartment and asked Ward for permission to talk to him and to enter the compartment.[211] Ward granted both requests.

The detective sat down between Ward and the door. The detective questioned Ward about his luggage and identification.[212] Ward stated that his only luggage was a shoulder bag, which he allowed the detective to examine.[213] Discovering a discrepancy between the names listed on Ward's ticket and his driver's license further aroused the detective's suspicion.

While these events took place between Ward and the detective, the agent discovered that Ward had boarded the train with two suitcases. The agent informed the detective of this fact.[214] The detective asked Ward if he possessed keys to the luggage. Ward consented to a search of his pockets which uncovered a key to the luggage. Ward subsequently produced three more keys, further tying Ward to the luggage despite the fact that he subsequently disclaimed ownership of the luggage.[215] These keys opened the luggage, the search of which led to the discovery of 41 pounds of marijuana and the arrest of Ward.[216]

The trial court denied Ward's motion to suppress the marijuana. Ward entered a conditional plea of guilty to possession of narcotics and subsequently appealed the denial of his motion to suppress.[217] The Tenth Circuit reversed the denial of the motion to suppress, holding the seizure and subsequent search of Ward's luggage was unlawful.[218]

b. *Opinion of the Court*

The court began by finding the initial information the officers possessed concerning Ward consistent with the concept of innocent travel. Consequently, that information was insufficient to provide the officers with a reasonable suspicion on which to base an investigatory detention.[219] However, the court did find the officers had reasonable suspicion to detain Ward upon learning of the discrepancies concerning the

210. *Id.* at 1529.
211. *Id.* at 1530.
212. *Id.*
213. *Id.* at 1529-30.
214. *Id.* at 1530.
215. *Id.* at 1535.
216. *Id.*
217. *Id.* at 1528.
218. *Id.* at 1536.
219. *Id.* at 1529.

identification and luggage.[220] Still, the search of Ward's luggage was illegal unless it could be determined Ward voluntarily consented to the questioning and subsequent search of his luggage. The court therefore defined the issue as whether the encounter between Ward and the officers was consensual.[221]

As the *Mendenhall-Royer* "free to leave" test is inapplicable to the setting of a train,[222] the court employed the test handed down by the Supreme Court in *Bostick*: "[W]hether a reasonable person would feel free to decline the officer's requests or otherwise terminate the encounter."[223] Noting the small size and frail condition of Ward,[224] the presence of two officers, with one officer seated between Ward and the door, and the fact the interrogation of Ward took place in a small roomette outside the view of other passengers, the court concluded that a reasonable person in Ward's position would have felt unable to decline the requests of the officers or terminate the encounter.[225] In addition, the officers did not make simple, general inquiries of Ward, but asked focused, potentially incriminating questions. As this form of questioning implied the investigation has focused specifically on the individual, that individual will feel less able to terminate the encounter.[226]

The court also distinguished *Bostick* from the instant case in that the officers in *Bostick* specifically advised Bostick of his right to terminate the encounter.[227] The officers gave no such advisement to Ward. Although such failure to advise is not determinative of whether a seizure took place, it should be afforded greater weight in light of the fact the encounter with Ward took place in a nonpublic setting.[228] Based on a totality of these circumstances, the court concluded Ward had been unlawfully seized at the point the officer first began asking Ward incriminating questions.[229]

Next, the court addressed the question of whether Ward voluntarily consented to a search of his pockets, which produced the first luggage key. The court pointed out that in order for the consent to be deemed voluntary, it must be sufficiently attenuated in time from the illegal detention.[230] Noting that Ward's consent to a search of his pockets occurred only minutes after the illegal seizure began, the court found no intervening circumstances which attenuated the two.[231] Accordingly, the court held Ward's consent to the search of his pockets was tainted by

220. *Id.* at 1530.
221. *Id.*
222. *See* Florida v. Bostick, 111 S. Ct. 2382, 2387-88 (1991).
223. *Id.* at 2387.
224. At the time, Ward was 5'7, weighed 145 pounds and had recently undergone a kidney transplant. *Ward*, 961 F.2d at 1533.
225. *Id.* at 1531-33.
226. *Id.* at 1532.
227. *Id.* at 1533.
228. *Id.*
229. *Id.* at 1534.
230. *Id.*
231. *Id.*

the prior illegal seizure, rendering the marijuana the fruit of such illegal seizure.[232]

The court applied the same analysis to determine whether Ward voluntarily disclaimed ownership of the bag. Like consent to search, when abandonment is preceded by an illegal seizure, the abandonment is only valid if sufficiently attenuated from the illegal seizure.[233] As the Government failed to prove such attenuation, the court found Ward's disclaimers of ownership tainted by the illegal seizure.[234] Accordingly, the Tenth Circuit reversed the denial of Ward's motion to suppress, and remanded for consistent further proceedings.

Two months after *Ward*, the Tenth Circuit, in an unpublished opinion, decided a similar case, *United States v. Arendondo*.[235] The totality of the circumstances, however, led the Tenth Circuit to affirm Arendondo's conviction for possession of drugs, as contrasted with *Ward*. A comparison of these two cases illustrates the Tenth Circuit's commitment to deciding search and seizure cases based solely on the totality of the circumstances.

### C. *Analysis*

The Supreme Court's lack of clarity in the realm of search and seizure allows the lower courts considerable leeway to decide when a seizure occurred. Whether a seizure has occurred should be determined by a realistic examination of the facts in each case. Rather than relying on the fact-specific "totality of the circumstances" test, many courts still apply the unrealistic *Mendenhall-Royer* "free to leave" test.[236] Courts appear comfortable applying a modified *Mendenhall-Royer* test to the search and seizure context.[237] However, a lack of uniformity in the "modified" versions adopted by the courts has resulted in inconsistent treatment of similar cases.

For example, encounters between police and suspected drug smugglers in airports are uniform,[238] yet determining at what point a seizure, if any, has occurred, is analyzed differently by different courts.[239] Some courts find the entire encounter illegal, as the officer lacked sufficient reasonable suspicion. Other courts find the encounter consensual,

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232. *Id.* at 1535.
233. *Id.*
234. *Id.* at 1535-36.
235. No. 91-2103, 1992 U.S. App. LEXIS 14654 (10th Cir. June 17, 1992). Tenth Circuit Rule 36.3 states that unpublished opinions and orders and judgments have no precedential value and shall not be cited except for purposes of establishing the doctrines of the law of the case, res judicata or collateral estoppel.
236. Butterfoss, *supra* note 135, at 463.
237. *Id.*
238. Agents develop a suspicion of a passenger usually arriving on a flight from a source city. *Id.* at 457. The agents follow the suspect, approach, identify themselves and ask if the suspect will talk with them. Then the agents ask to see the suspect's ticket and identification. At this point the agents either ask the suspect to accompany them to an office for further questioning or ask for consent to search their luggage. If consent is given and drugs are found, the suspect is arrested. *Id.* at 457-58.
239. *Id.* at 458.

therefore, no seizure occurred. Often courts find a seizure which is justified by the requisite level of suspicion, and hence is legal.[240]

Almost all courts agree that officers merely approaching individuals, requesting to speak with them, and asking for identification does not constitute a seizure.[241] Many courts find a seizure has occurred at some point in the encounter, but hold different views as to when that seizure took place. These points vary from retention of the passenger's ticket and identification,[242] the officer informing the individual of his suspicions,[243] asking the individual a question designed to confirm or dispel suspicion,[244] the officer asking the individual to accompany him to another location,[245] requesting permission to search[246] and threatening to seek a search warrant.[247] The result of these inconsistent applications of the *Mendenhall-Royer* test is the varied treatment of essentially identical situations.

The lack of bright-line rules provided by the Supreme Court as to when a seizure has taken place results in fewer restrictions placed upon police conduct.[248] In 1969, Professor Tiffany suggested one result of *Terry's* ambiguity may be increased judicial intervention to control police practices if the relevant policing agencies do not undertake to do it themselves.[249] However, judicial intervention since *Terry* has done little to clarify this area of law. In the twenty-four years since *Terry*, the Supreme Court has handed down *Mendenhall, Royer* and *Bostick* providing the ambiguous "reasonable person," "free to leave" and "free to terminate the encounter" tests. Courts have difficulty interpreting these tests and policing agencies show increasing tendencies to exploit rather than help clarify the ambiguity. Hard to apply, difficult to define tests do little to clarify search and seizure doctrine.

Professor Butterfoss pointed out the *Mendenhall-Royer* test may not even be true to the principles of *Terry*.[250] Terry held that "whenever a police officer accosts an individual and restrains his freedom to walk away, he has 'seized' that person."[251] The *Terry* court emphasized this

240. *Id.*
241. *Id.*
242. United States v. Thompson, 712 F.2d 1356 (11th Cir. 1983) (seizure occurred when officer held license while making additional requests).
243. United States v. Hanson, 801 F.2d 757 (5th Cir. 1986) (seizure occurred when officer retained suspect's drivers license).
244. United States v. Gallego-Zapata, 630 F. Supp. 665 (D. Mass. 1986) (seizure occurred when officers identified themselves and asked defendant from where he came).
245. United States v. Lehmann, 798 F.2d 692 (4th Cir. 1986) (no seizure until agents asked defendant in airport parking lot to accompany them to F.A.A. office).
246. United States v. Gonzales, 842 F.2d 748 (5th Cir. 1988) (encounter became seizure when federal agent told suspect he was a narcotics officer and requested permission to look in suspect's bag), *overruled by*, U.S. v. Hurtado, 905 F.2d 74 (5th Cir. 1990).
247. United States v. Pirelli, 650 F. Supp. 1254 (D. Mass. 1986) (consensual encounter became seizure when officers threatened to obtain search warrant unless suspect consented to search).
248. *See* Tiffany, *supra* note 132, at 453.
249. *Id.*
250. Butterfoss, *supra* note 135, at 480.
251. *Terry*, 392 U.S. at 16.

determination can only be made "in light of the particular circumstances."[252] Justice Stewart in *Mendenhall* converted the *Terry* detention test to a "reasonable person"[253] test, placing more emphasis on that unrealistic subjective standard rather than the necessary objective standard of focusing on the particular circumstances.

Viewed in this light, it appears the Tenth Circuit in *Ward*, while it may have modified *Mendenhall-Royer*, remained true to *Terry*. In *Ward*, the court tested "the limits of *Bostick* in an encounter in a small private compartment of a train."[254] However, examination of *Ward* has shown that the fact the encounter took place on a train was but one element factored into the real questions posed by *Ward*. The first question asked if Ward was detained, and if so, whether that detention was legal. The second question asked, regardless of the legality of the detention, whether Ward voluntarily consented to the search of his pockets and luggage. As these are the principle questions addressed in every search and seizure case, *Ward*, while it may add a twist in that it occurred on a train, is no different.

In deciding whether Ward had been detained, the Tenth Circuit placed great emphasis on the fact Ward was subjected to potentially incriminating questioning, but did not base its decision on that fact alone.[255] Rather, that fact, when combined with the "totality of the circumstances"[256] gave rise to the illegal detention. That *Ward* does not stand for a *per se* rule prohibiting the asking of train passengers potentially incriminating questions is evidenced by the unpublished opinion the Tenth Circuit handed down two months after *Ward*, in *United States v. Arendondo*.[257]

In *Arendondo*, the same DEA agent involved in *Ward*, Agent Small,[258] boarded an Amtrack train in Albuquerque. Unlike the situation in *Ward*, Agent Small did not act pursuant to a tip. Agent Small's attention was drawn to Arendondo when he saw Arendondo, who did not appear handicapped, sitting in the handicapped section of the train.[259] Agent Small approached Arendondo, displayed his badge and asked to speak to him. Arendondo agreed.[260] Agent Small next asked to see

252. *Id.* at 21.

253. Butterfoss, *supra* note 135, at 480.

254. United States v. Ward, 961 F.2d 1526, 1528 (10th Cir. 1992).

255. *Id.* at 1532, 1534. In contrast, the Tenth Circuit has held that asking incriminating questions absent reasonable suspicion renders a detention illegal in the setting of routine traffic stops. In United States v. Guzman, 864 F.2d 1512 (10th Cir. 1988), an officer stopped the defendant for not wearing a seat belt. The court ruled the officer lacked reasonable suspicion to detain and question the defendant further outside the purpose of the stop. The Tenth Circuit followed this opinion three years later in United States v. Walker, 941 F.2d 1086 (10th Cir.), *cert. denied*, 112 S. Ct. 1168 (1991).

256. *Ward*, 961 F.2d at 1534.

257. No. 91-2103, 1992 U.S. App. LEXIS 14654 (10th Cir. June 17, 1992).

258. Agent Small was involved in yet another train case in 1992. *See* United States v. Bloom, 975 F.2d 1447 (10th Cir. 1992). The Tenth Circuit did not materially distinguish *Bloom* from *Ward*, and applied *Ward* to reverse the district court's denial of the motion to suppress. *Id.*

259. *Arendondo*, 1992 U.S. App. LEXIS 14654, at *2.

260. *Id.*

Arendondo's ticket, which Arendondo produced, and Arendondo's identification, which Arendondo said he did not have. At this point Agent Small informed Arendondo he "was a DEA agent who daily boarded the train looking for people traveling alone and carrying narcotics."[261] Arendondo replied he did not have any drugs. Agent Small then asked for permission to search Arendondo's luggage "to make sure they don't contain any drugs."[262] Arendondo consented, the search uncovered drugs, and Arendondo was arrested.

The Tenth Circuit affirmed the conviction of Arendondo. The Tenth Circuit distinguished this case from *Ward* because the agents questioned Ward in "physically intimidating surroundings" as compared to the fact Arendondo was questioned in "an open public car immediately in front of an exit."[263] In addition, two officers questioned Ward while one questioned Arendondo. Moreover, the court noted physical size greatly favored Arendondo, whereas Ward was diminutive.[264]

*Ward,* when read in conjunction with *Arendondo*, can be viewed not so much as registering dissent to the holding of *Bostick*, but as registering dissent to the application of unrealistic tests, like *Mendenhall-Royer.* Cases cannot be decided based solely on the location of the encounter, or on what an artificial "reasonable person," who is much more assertive than the average citizen,[265] might feel. Rather, courts must base their decisions solely on the "concrete factual context of the individual case."[266] Courts must examine whether the encounter involved aggression, authoritative commands or blockage of passage.[267] Courts should look to whether the officer visibly displayed his weapons or physically intimidated or threatened the suspect.[268] Also relevant is whether the encounter took place at an unusual time or place.[269] No single factor may be dispositive of whether a seizure has occurred implicating the Fourth Amendment; rather, it depends on the totality of all the circumstances surrounding the incident.[270]

While the Supreme Court received much criticism for its imprecise tests, no alternative exists. If each case is truly to be decided on the basis of assessing the "coercive effect of police conduct, taken as a whole, rather than to focus on particular details of that conduct in isola-

261. *Id.* at *3.
262. *Id.*
263. *Id.* at *8 n.8.
264. *Id.*
265. Butterfoss, *supra* note 135, at 439. The reality is citizens virtually never feel free to walk away when approached by a police officer. *Id.*
266. Sibron v. New York, 392 U.S. 40, 59 (1968).
267. *Cf.* Michigan v. Chesternut, 486 U.S. 567, 575 (1988) (police presence alone does not constitute seizure).
268. *Cf.* United States v. Brady, 842 F.2d 1313, 1314 (D.C. Cir. 1988) (defendant faced none of the factors typically found to intimidate persons into thinking compliance is obligatory).
269. *Id.*
270. *Chesternut*, 486 U.S. at 572.

tion,"[271] the test must be imprecise to accommodate varying facts. Search and seizure doctrine became more unclear when the Supreme Court adopted the unrealistic "reasonable person free to leave or terminate the encounter" test. In contrast, the Tenth Circuit has consistently adhered to examining the seizure "in light of the particular circumstances"[272] and in that sense, has remained true to *Terry*.

## IV. CONCLUSION

During the survey period, the Tenth Circuit demonstrated independence in the areas of sentence enhancement and search and seizure. In *Abreu*, the Tenth Circuit rejected the reasoning adhered to by six other circuits as to the applicability of a sentence enhancement provision. However, because of the apparent inconsistency between *Abreu* and *Green*, the Tenth Circuit's sentence enhancement doctrine remains unclear. In *Ward*, the Tenth Circuit registered its dissent to the unrealistic *Mendenhall-Royer* test and reasserted the importance of deciding search and seizure cases based on the totality of the circumstances. In so doing, the Tenth Circuit refused to extend the Supreme Court's holding in *Bostick* to the setting of private train compartments. It will be interesting to see if the Supreme Court finds it necessary to harness the independence demonstrated by the Tenth Circuit in 1992.

*Martha A. Paluch*

271. *Id.* at 573.
272. Terry v. Ohio, 392 U.S. 1, 21 (1968).

# EMPLOYMENT LAW SURVEY

## I. INTRODUCTION

The Tenth Circuit Court of Appeals grappled with several difficult issues in 1992. The employment cases decided by the court mostly dealt with procedural due process in public employment. The court continued its narrow construction of the procedural rights of government employees. It applied a high standard necessary for plaintiffs to establish a protected property interest and established a low standard for defendants to meet to comply with Fourteenth Amendment requirements. In *Brown v. Independent School District No. I-06*,[1] the court narrowly construed the word "termination" in a statute protecting school employees from arbitrary discharge so as to exclude employees with contracts not renewed by the school district. In *Driggins v. City of Oklahoma City*,[2] the court held personnel policies enacted by city officials protecting city employees did not override employment-at-will provisions of the Oklahoma City Charter. Similarly, in *Phillips v. Calhoun*[3] the court held a section of the city code which transferred the plaintiff into a protected classification did not override the at-will provisions of the city charter. But in *Patrick v. Miller*,[4] a merit clause of the city charter was found to take precedence over other at-will language of the charter.

In 1992 the Tenth Circuit also considered using a Title VII analogy to resolve issues arising under the Age Discrimination in Employment Act in both the substantive and procedural context. In *Oestman v. National Farmers Union Insurance Co.*,[5] the court applied the same test used in Title VII discrimination cases to determine whether a plaintiff is an employee protected by the Act or an unprotected independent contractor. The court rejected the Title VII analogy in the statute of limitations context in *Aronson v. Gressly*.[6]

## II. GOVERNMENT EMPLOYMENT AND DUE PROCESS

Government employees found the Tenth Circuit unreceptive to their claims in 1992. It narrowly defined "property interest" and relaxed its standard of procedural due process to restrict governmental employee rights in the termination context.

### A. *Defining Property Interest*

Through the use of Section 1983,[7] government employees have

1. 974 F.2d 1237 (10th Cir. 1992).
2. 954 F.2d 1511 (10th Cir. 1992).
3. 956 F.2d 949 (10th Cir. 1992).
4. 953 F.2d 1240 (10th Cir. 1992).
5. 958 F.2d 303 (10th Cir. 1992).
6. 961 F.2d 907 (10th Cir. 1992).
7. 42 U.S.C. § 1983 (1988). Section 1983 states:

availed themselves of the protections in the Due Process Clause of the Fourteenth Amendment as a weapon against workplace discrimination. Under the Supreme Court's rulings in *Cleveland Board of Education v. Loudermill*,[8] and *Board of Regents v. Roth*,[9] plaintiffs must show (1) that they had a protected property interest in continued employment[10] and (2) that they were deprived of such interest without due process of law as defined in *Mathews v. Eldridge*.[11] In 1992 the Tenth Circuit used a literal interpretation of the standard set forth in *Loudermill*, *Roth* and *Matthews* in establishing a property interest protected by the Fourteenth Amendment.

1. Tenth Circuit Case Law

The classic case where the courts are unwilling to find a protected property interest in continued employment is a complaining employee under a definite-term contract that is not renewed by the government entity. In that situation, the employee has no reasonable expectation of continued employment and is unprotected from non-renewal. This principle guided the court's analysis in *Brown v. Independent School District No. I-06*.[12]Outside of the classic scenario, the court used a formalistic interpretation of municipal and state law to reject constitutional claims in *Driggins v. City of Oklahoma City*[13] and *Phillips v. Calhoun*.[14] But in *Patrick v. Miller*,[15] the court resolved a conflict among city charter provisions in favor of a complaining employee.

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Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

8. 470 U.S. 532 (1985). Loudermill was hired as a security guard by the Cleveland Board of Education. On his application he indicated that he had never been convicted of a felony. The Board subsequently discovered that he had been convicted of larceny, a felony under Ohio law, and terminated him. Loudermill filed suit complaining that the Board's summary dismissal of him without any pre-termination hearing or procedure violated his due process rights. Because he was a classified civil servant under Ohio law, the Court held that he could only be terminated for cause and was entitled to a pre-termination opportunity to respond and a post-termination administrative review.

9. 408 U.S. 564 (1972). The Court held that Roth, a teacher employed under a one-year contract by a state college, failed to establish a protected property interest because he had not acquired tenure according to Wisconsin law. The Court also held that the Fourteenth Amendment does not require an opportunity for a hearing prior to the non-renewal of a nontenured teacher's contract, where, as here, the teacher fails to come forward with evidence of stigma or disability foreclosing other employment or terms of his employment conferring a protected property interest.

10. Employees often assert state statutes, city ordinances, city charters or employment contracts as a source of protected property interest in procedural due process cases. *See* JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW 513-21 (4th ed. 1991).

11. 424 U.S. 319, 343 (1976). In *Eldridge*, the Court held that the interests of the government in obtaining a summary decision in the dispute must be balanced against the dangers of arbitrary or erroneous decisions inherent in a summary proceeding in determining whether Due Process requirements have been met.

12. 974 F.2d 1237 (10th Cir. 1992).

13. 954 F.2d 1511 (10th Cir. 1992).

14. 956 F.2d 949 (10th Cir. 1992).

15. 953 F.2d 1240 (10th Cir. 1992).

a. *Brown v. Independent School District No. I-065*

The plaintiffs were employed as secretaries of an Oklahoma school district.[16] Both worked in that capacity for many years and were parties to a series of one-year employment contracts.[17] In June of 1989, the school board voted not to enter into new contracts with the employees.[18] The employees sought a hearing with the board to discuss the reasons for its decision not to renew their contracts and were refused. The board also refused to offer any reasons for their decision.[19] The employees then sued and the district court granted the board's motion for summary judgment, holding that plaintiffs had no protected property interest in continued employment with the school district.[20]

On appeal, the employees argued that Oklahoma statutes as well as the school board's policy created a sufficient basis to assert a constitutionally protected property interest. The statutory provision prohibited the suspension, demotion or termination of certain employees the plaintiffs except "for cause."[21] The court held that termination, for the purposes of the statute, does not include the natural death of the contract.[22] Therefore, the "for cause" language did not apply to the decision not to renew the employees' contract and the employees could not claim a property right on that basis.[23]

The employees then asserted a property right based on the school board policy contained in an employee handbook. "The continuation of employment shall be based on the quality of work, ethical conduct, necessity of the work and the availability of district funds."[24] The Tenth Circuit held that the handbook only restated the termination requirements in the statute and did not apply to the natural death of the contract.[25] The handbook was not sufficient to create a property interest protected by procedural due process.

b. *Driggins v. City of Oklahoma City*

In *Driggins v. City of Oklahoma City*,[26] the Tenth Circuit held that city personnel policies requiring employees be discharged only "for cause" do not negate contradictory city charter provisions.[27] The Oklahoma

16. *Brown*, 974 F.2d at 1238.
17. *Id.*
18. *Id.* at 1239.
19. *Id.*
20. *Id.*
21. OKLA. STAT. tit. 70, § 6-101.40 (Supp. 1993). The statute reads:
A support employee who has been employed by a local board of education for more than one (1) year shall be subject to suspension, demotion or termination only for cause, as designated by the policy of the local board of education . . . . This section shall not be construed to prevent layoffs for lack of funds or work.
22. *Brown*, 974 F.2d at 1240.
23. *Id.*
24. *Id.*
25. *Id.* at 1240-41. "[W]e interpret the provision to refer to termination of an existing contract rather than to a failure to renew a contract."
26. 954 F.2d 1511 (10th Cir. 1992).
27. *Id.* at 1514-15.

City Charter provided that city employees could be terminated for any reason construed to be in the interest of the service.[28] The Oklahoma Supreme Court had previously held that city employees working under the "interest of service" provisions of a city charter did not have a property interest subject to due process protection.[29] In *Driggins*, the Tenth Circuit agreed that such provisions in the charter precluded the plaintiff from claiming a protected property interest in continued employment.[30]

The plaintiff in *Driggins* was an employee of the City of Oklahoma City as a human resources specialist. At the time of termination, the plaintiff was a six-year employee of the city.[31] Driggins argued three factual bases for constitutional protection from termination without procedural due process: (1) City Council regulations suggest that city employees could only be discharged "for cause;" (2) an informal but mutual understanding existed between Driggins and the city that she was a permanent employee and could only be terminated for cause; and (3) as an employee of a federally funded Comprehensive Employment and Training Act (CETA) program,[32] Driggins had a protected property interest "by virtue of CETA's mandate that participating state and local governments adopt a merit[-based] personnel system."[33]

The trial judge submitted the question of Driggins's possible constitutionally protected property interest in continued employment with the city to the jury, which found in the affirmative.[34] The Tenth Circuit reversed, holding that when a city charter contains a provision empowering the city manager to terminate employees "for the good of the service," the existence of a protected property interest should be determined by the court as a matter of law.[35] The Tenth Circuit then reviewed the issue *de novo* and held that, given the city charter provisions, Driggins did not have a protected property interest in continued employment with the city.[36]

The court reasoned that, with the aforementioned city charter provisions and the charter's grant of all authority in employment decisions to the city manager, the city council resolution establishing a "for cause" personnel policy did not bind the city and did not establish a property interest for due process purposes.[37]

The court also rejected the plaintiff's second argument for the existence of a mutual understanding that she would only be terminated

28. *Id.* at 1514. The court noted that Article III, Sec. 1 of the Oklahoma City Charter states that "removals and demotions shall be made solely for the good of the service."

29. Hall v. O'Keefe, 617 P.2d 196 (Okla. 1980).

30. *Driggins*, 954 F.2d at 1514-15.

31. *Id.* at 1512.

32. 29 U.S.C. §§ 802-992 (1975). CETA has since been repealed, Pub. L. No. 97-300, § 184(a)(1), 96 Stat. 1357 (1982), but the plaintiff was employed while the Act was still in effect. *See Driggins*, 954 F.2d at 1515.

33. *Driggins*, 954 F.2d at 1515.

34. The reported opinion does not cite to the district court opinion nor does it delve into the reasoning of the jurors in finding that such a property interest existed.

35. *Driggins*, 954 F.2d at 1513.

36. *Id.*

37. *Id.* at 1514.

for just cause that would establish a protected property interest.[38] The court recognized the fact that mutual understandings can be the source of a property interest,[39] but refused to recognize such an interest here:

> Driggins points to no authority, however, for the proposition that mutually explicit understandings can give rise to a protected property interest where an express city charter provision allows employees to be discharged "solely for the good of the service."[40]

Finally, the court held that Driggins failed to point to any provision of CETA which imposed substantive restrictions on city officials in terminating employees. The court reasoned that even if CETA conferred additional rights on employees after its repeal, it did not confer a protected property interest in continued employment to city employees.[41]

c. *Phillips v. Calhoun*

Under a similar fact situation, the court found no protected property interest in continued employment in *Phillips v. Calhoun*.[42] In *Phillips*, the city charter of Sand Springs, Oklahoma contained language identical to that found in the Oklahoma City Charter in *Driggins*. A city attorney

38. *Id.* at 1515.

39. *Id.* The court cited Vinyard v. King, 728 F.2d 428, 430 (10th Cir. 1984), for the proposition that mutual understanding "can create a property interest in continued employment by means of an implied contract." In *Vinyard*, a hospital's director of volunteer services successfully argued that a protected property interest in continued employment had been created by the hospital when it distributed an employee handbook. *Id.*

40. *Driggins*, 954 F.2d at 1515.

41. *Id.* at 1516.

42. 956 F.2d 949 (10th Cir. 1992). An interesting variation on this theme was set out by the court in Farnsworth v. Town of Pinedale, 968 F.2d 1054 (10th Cir. 1992). In *Farnsworth* the court affirmed the district court's granting of defendant's motion for summary judgment.

Farnsworth and other city employees claimed that they were discharged without any procedure after a municipal election. *Id.* Immediately following the election, the new mayor and two new councilmen voted to repeal certain personnel policies and not to reappoint plaintiffs. *Id.* Plaintiffs objected claiming that they had a protected property interest in continued employment with the city that could not be revoked without due process of law. *Id.*

While the Tenth Circuit agreed that the plaintiffs had established a constitutionally protected property interest, the court found that such interest did not extend beyond the term of the political officials who appointed them. In construing several provisions of the Wyoming statutes to preclude town councilmen and mayors from making appointments which are for a duration longer than their own terms of office, the court rejected plaintiffs' § 1981 claims:

> Appellants . . . possessed a constitutionally protected property right in continued employment. However, that right extended only until the end of their term of office, at which time the incoming mayor and town council had the option to replace them by the authority granted by Wyoming Statute § 15-2-102(a).

*Id.* at 1057.

As in *Driggins* and *Phillips*, the court in this case concentrated on the formalistic municipal procedures to determine the extent of the protected property interest. There were several ambiguities and contradictions in the Wyoming statutory scheme. To affirm summary judgment in this case seems to imply that the existence and the extent of a constitutionally protected property interest in continued employment will always be a question of law to be decided by the judge, completely taking the expectations, no matter how reasonable, of the plaintiff/government employee out of the due process analysis. This is an unfortunate result. *See* discussion *infra* section I.A.2.

filed a § 1983 claim for wrongful discharge claiming that some procedural safeguards granted by the charter to classified employees created a protected property interest in continued employment.

The district court held as a matter of law that the plaintiff was an unclassified employee and, therefore, granted defendant's motion for summary judgment. On appeal, the plaintiff argued that even if he was an unclassified employee under the charter, § 2-617 of the city code, "subsequently effected his transfer into the classified service."[43] However, the Tenth Circuit held that such a classification was contrary to the city charter and was therefore a nullity, leaving plaintiff with no protected property interest in that the "for the good of the service" language of the charter "[did] not create a cognizable interest in employment."[44]

d. *Patrick v. Miller*

In *Patrick v. Miller*,[45] a Tenth Circuit panel headed by Judge Brorby held that an at-will city charter provision did not defeat the plaintiff's claim to a protected property interest when another provision of the charter required employment decisions be made on merit alone.[46]

The trial judge denied Miller's motion for summary judgment on Patrick's § 1983 claim and the defendants appealed.[47] Judge Brorby reasoned that if precedent allowed city charter provisions confer complete discretion in employee discharges that would necessarily defeat any claims of protection from wrongful discharge, the converse must also be true:

> Where a city charter restricts a city manager's authority to terminate employees, Oklahoma courts would not allow city officials to alter those terms so as to expand their authority to the detriment of employees. City employees therefore have a legitimate expectation of continued employment to the extent that a city charter limits its officials' power to terminate such employment.[48]

The panel upheld the district court's refusal to grant summary judgment on plaintiff's section 1983 claim.[49]

2. Analysis

In rejecting the protected property claims in *Brown* and *Driggins*, the Tenth Circuit went to great lengths to trammel government employees' due process rights. The court held that when there is an at-will or equivalent provision in a city charter, the question of the existence of a protected property interest is a matter of law to be decided by the court.

43. *Phillips*, 956 F.2d at 952.
44. *Id.* at 953.
45. 953 F.2d 1240 (10th Cir. 1992).
46. *Id.* at 1245.
47. *Id.* at 1242.
48. *Id.* at 1244-45.
49. *Id.* at 1246.

The court in *Driggins* relied primarily on city charter provisions and a restrictive Oklahoma Supreme Court decision interpreting those provisions[50] permitting the termination of employees for the good of the service. The court elevated these obscure city charter "at-will" and "good of the service" caveats to complete disclaimer status revoking any due process rights granted by the city to its employees.

The court ruled this way despite the fact that the Supreme Court cases in this area turn on the mutual expectations of the government and its employees, rather than the formal authority of city officials.[51] While the court correctly addressed the issue of whether Oklahoma state law conferred a property right upon the plaintiffs in *Driggins* and *Phillips*, it ignored the fact that such a protected interest may also be created by contract or mutual understanding.[52]

The Supreme Court has afforded the circuits the opportunity to broadly interpret property interests for due process purposes and it is troubling that the Tenth Circuit discarded the logic and spirit of the mutual understanding doctrine in favor of a formalistic interpretation of municipal authority. State cases within the Tenth Circuit that have addressed the issue of at-will employees' enforcement of procedural benefits promised subsequent to the commencement of employment have held that the expectations of the employee create the procedural rights.[53] Such a rule is as logical as it is equitable and should be adopted by the Tenth Circuit.

Although the court used the same analysis in *Patrick* that it used in *Driggins* and *Phillips* (that the provisions of the city charter are controlling), the decision was different. The court found that, unlike the charter in *Driggins*, the Norman City Charter in *Patrick* provided that

50. *O'Keefe*, *supra* note 29. It should also be noted that the Tenth Circuit previously held that the "for the good of the service" language found in city charters does not confer a property interest to city employees. *See* Campbell v. Mercer, 926 F.2d 990 (10th Cir. 1991); Lane v. Town of Dover, 761 F. Supp. 768 (W.D. Okla. 1991), *aff'd*, 951 F.2d 291 (10th Cir. 1991).

51. *See, e.g.*, Board of Regents v. Roth, 408 U.S. 564, 577 (1972), Bishop v. Wood, 426 U.S. 341, 344 n.6 (1976), Perry v. Sinderman, 408 U.S. 593, 601 (1972) ("[a] person's interest in a benefit is a 'property interest' if there are . . . mutually explicit understandings that support his claim of entitlement").

Commentators argue that "[i]f the government gives the employee assurances of continual employment or dismissal . . . then there must be a fair procedure to protect the employee's interests when the government seeks to discharge him [or her] from the position." NOWAK & ROTUNDA, *supra* note 10, at 519.

52. NOWAK & ROTUNDA, *supra* note 10, at 519 (protected interest may also "come from statutory law, formal contract terms, or the actions of a supervisory person with authority to establish terms of employment"). Whether apparent authority, as the term is used in the common law of agency, is sufficient to establish a protected interest was not addressed in *Driggins* but would probably not find a receptive audience in the Tenth Circuit given its formalistic approach to the powers of the municipal entities and the relationship of ordinances to organic charters.

53. *See e.g.*, Continental Air Lines v. Keenan, 731 P.2d 708 (Colo. 1987). Keenan was hired by Continental for an indefinite term and was an at-will employee. Keenan was summarily discharged and sued claiming that an employee manual created reasonable expectations of procedural due process prior to termination. The trial court granted Continental's motion for summary judgment based on the at-will rule but the Supreme Court of Colorado reversed and remanded.

employment decisions "shall be made upon the basis of merit and fitness alone."[54] Because the "for cause" language asserted by the plaintiff in *Driggins* appeared only in a city council resolution, the at-will language of the charter in that case was dispositive. This distinction's helpfulness is questionable. In the aggregate, the rule implied by these cases appears to be that the quantum of protection to be afforded public employees is to be determined solely by the source of the interest. Under this rule, expectations created by a municipal authority are meaningless unless supported by city charter provisions. A rule that excludes property interests in continued employment as a matter of law for the sole reason that an "at-will" or similar provision exists in the city charter is unduly harsh and lacks logical justification. A better rule would be to allow the question to be submitted to a jury if the plaintiff comes forth with some evidence of a protected interest (e.g., a handbook, municipal ordinance, policy or resolution). A *per se* finding of no protected interest in any case where there is an "at-will" charter provision significantly undermines the Due Process protections of the Fourteenth Amendment.

### B. The Sufficiency of the Process

Once a plaintiff establishes a protected property interest, the issue becomes whether the government actor provided sufficient procedural redress to protect that property interest. The Supreme Court has provided three primary factors to be used in determining what process is due:

> First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.[55]

Establishing a plaintiff's deprivation of a protected property interest does not automatically entitle that plaintiff to a formal hearing. "What is required is procedure, not necessarily a hearing."[56] The courts must balance the three factors set forth in *Matthews* to determine what process is due.

#### 1. Tenth Circuit Case Law

The Tenth Circuit considered the sufficiency of process in two cases in 1992, *West v. Grand County*[57] and *Aronson v. Gressly*.[58] In both cases, the court held that although the employees successfully established a

54. *Patrick*, 953 F.2d at 1245.
55. Matthews v. Eldridge, 424 U.S. 319, 335 (1976).
56. NOWAK & ROTUNDA, *supra* note 10, at 530.
57. 967 F.2d 362 (10th Cir. 1992).
58. 961 F.2d 907 (10th Cir. 1992).

protected property right, the limited procedure afforded them by the governmental entities sufficiently satisfied due process requirements.

a. *West v. Grand County*

The Tenth Circuit had no trouble finding a protected property interest in *West v. Grand County*. The county provided employee handbooks which prohibited the discharge of permanent employees except for cause, for reasons of curtailment of work or for lack of county funds. The court held that, given these provisions, plaintiff West possessed a protected property interest in continued employment.[59] "The record and the case law clearly establish that West had a protected property interest [and] was thereby entitled to due process."[60]

West's primary contention was the denial of her procedural protections as required by the Fourteenth Amendment. Her supervisor, just elected to County Attorney, cited a reduction in force as the sole reason for her discharge. West claimed that she was the victim of subterfuge aimed at discharging her solely because of her ties to the previous administration.[61] Prior to her termination, West met with the incoming County Attorney, Coates, to discuss the reasons for her probable termination. At that time, she had an opportunity to respond to Coates as well as to the County Commissioners concerning the proffered reasons for her discharge.[62] This procedure, the court held, was sufficient to satisfy due process requirements.

Citing *Cleveland Board of Education v. Loudermill*,[63] and the Tenth Circuit cases which applied the *Loudermill* rule,[64] the court held that a full evidentiary hearing was not required prior to termination in order to comply with procedural due process.[65] Rather, the court held:

> A full evidentiary hearing is not required prior to an adverse employment action. The individual entitled to due process protection needs only to be given notice and an opportunity to respond. We have held that pretermination warnings and an opportunity for a face-to-face meeting with supervisors, and a conversation between an employee and his supervisor immediately prior to the employee's termination were sufficient to satisfy constitutional requirements.[66]

West argued that her post-termination hearing was constitutionally insufficient in that: (1) she was not given the opportunity to challenge the evidence of those seeking to terminate her; (2) the Commissioners presiding over the hearing were not impartial; and (3) the Commission-

59. *West*, 967 F.2d at 366.
60. *Id.*
61. *Id.* at 367-68.
62. *Id.* at 368.
63. 470 U.S. 532 (1985).
64. Powell v. Mikulecky, 891 F.2d 1454 (10th Cir. 1989); Seibert v. Oklahoma *ex rel.* Univ. of Okla. Health Sciences Ctr., 867 F.2d 591 (10th Cir. 1989).
65. *West*, 967 F.2d at 367.
66. *Id.* (citations omitted).

ers based their decision on *ex parte* communications.[67] In rejecting West's arguments, the court held that the post-termination hearing afforded the plaintiff was sufficient to protect her property interest.

The court further held that because West did not seek to have Coates present at the hearing, she could not complain of her inability to confront him at that time.[68] West's attorney objected at the time of the hearing to the fact that commissioners who were involved in the decision to terminate West were conducting the hearing, but because the attorney agreed to go forward with the hearing, the court held that he expressly waived West's right to object to the lack of impartiality of the hearing officers.[69] Finally, the court held that West's allegation that the decision was a result of *ex parte* communication was unsubstantiated speculation.[70]

b. *Aronson v. Gressly*

The Tenth Circuit had less difficulty in considering the issue of what quantum of process is due public employees in *Aronson v. Gressly*.[71]

In that case Aronson, a biographical specialist at the American Heritage Center at the University of Wyoming, was terminated.[72] After being turned down for a promotion, allegedly because of her age, and after having a succeeding Director of the Center redefine her position, Aronson refused to report to work.[73] She was warned on multiple occasions by mail that her continued insubordination would result in termination and she continued to refuse to report for work. She was terminated on April 25, 1988.[74] Aronson was reinstated as a full-time library employee with back pay and benefits after going through the established grievance procedures.[75] She filed suit in federal court, however, alleging deprivation of her protected property interest in continued employment without due process of law.[76] The trial court granted the defendant's motion for summary judgment and Aronson appealed.[77]

Applying the notice and opportunity to be heard standard of *Loudermill*, the Tenth Circuit held that Aronson had been afforded adequate procedure to comply with the Fourteenth Amendment:

> In short, Aronson received ample opportunity to return to work or to respond to the University's charges. Aronson

67. *Id.* at 369.
68. *Id.*
69. *Id.* at 370.
70. *Id.*
71. 961 F.2d 907 (10th Cir. 1992).
72. *Id.* at 908.
73. *Id.*
74. *Id.*
75. *Id.*
76. *Id.* at 909. Plaintiff alleged that the treatment she received from the University violated the Age Discrimination in Employment Act and the Due Process Clause of the Fifth and Fourteenth Amendments. The trial court granted the University's motion for summary judgment on both of these claims. *Id.*
77. *Id.*

> clearly had an opportunity to present her side of the story. Certainly, the Due Process Clause requires no more prior to termination.[78]

2. Analysis

The court's opinion in *West* represents the faults in the Tenth Circuit's application of the procedural due process doctrine. Requiring only notice and an opportunity to respond prior to termination leaves government employees far too vulnerable to arbitrary or discriminatory treatment, especially those who are terminated for reasons of patronage rather than merit. Under the rule set forth in *West*, a reviewing court need not delve into the substance of the process provided, but may satisfy itself with the fact that some basic notice and an opportunity to respond was provided prior to termination. A better rule requires courts to make an initial inquiry into the fairness and sincerity of the proceedings, making it more difficult for government employers to immunize themselves from due process challenges by simply promulgating procedures consisting more of form than substance.

In *West* the court's failure to consider the bias of the post-termination hearing commission is especially troubling. Plaintiff's counsel raised the issue at the hearing and objected for the record. The court held that the attorney's choice to proceed despite the possible bias of the hearing officials "expressly waived" the plaintiff's right to object.[79] Again, the court used unduly formalistic rules in defeating the rights of an aggrieved government employee. If the Due Process Clause of the Fourteenth Amendment does not require a full evidentiary hearing, but something less formal,[80] it is unclear why the court insisted on holding the plaintiff to a strict procedural standard for objection and waiver. Clearly, if the court is not willing to require a formal hearing concerning the property interests of government employees, then it should follow that such employees should not be held to the strict evidentiary and procedural standards of the judicial process. West's attorney made the objection to the potential bias of the Commissioners for the record.[81]

78. *Id.* at 910.

79. *West*, 967 F.2d at 370.

"West's attorney expressed his misgivings regarding the neutrality of the commissioners on the panel at the grievance hearing, but then stated that he was willing to proceed:

> If the three of you were involved in the process of the decision to terminate Trish it might be appropriate if there was a neutral arbitrator or neutral hearing officer appointed to hear this grievance instead of having the commission hear it. . . . We're prepared to present testimony. . . . I just wanted to raise that for the record — That is a concern that we have. I'm not suggesting that the three of you would be in any way biased or anything — it just might be an easier situation. If you want to proceed, we're prepared.

He then proceeded without either requesting or obtaining a ruling form the Commissioners on his suggestion that they might not be impartial. In doing so, he expressly waived West's right to object to the partiality of the decisionmakers at the grievance hearing." *Id.* (quoting record of the grievance hearing).

80. *See supra* notes 53-54 and accompanying text.

81. *West*, 967 F.2d at 370.

Given the informality of the required proceeding, the mere fact that the attorney did not refuse to proceed with the hearing should not have precluded West from raising the bias issue on appeal.

Although the court in *Aronson* used the same low sufficiency of process standard as it used in *West*, the result is more palatable. Here, Aronson, through her own conduct, affirmatively rejected opportunities to appear to answer the charges of the director of the American Heritage Center.[82] The several and explicit offers at procedure and reconciliation were rebuffed by Aronson and for her to then sue based on the failure of the University to provide her with pre-deprivation due process was properly recognized by the court as groundless.

## II. THE AGE DISCRIMINATION IN EMPLOYMENT ACT (ADEA)

The Age Discrimination in Employment Act[83] prohibits employment discrimination against individuals over 40 years of age. The act prohibits discrimination in hiring, discharge and other acts affecting the terms and conditions of employment based on an individual's age. Also, retaliatory action taken by an employer against an employee who opposes a discriminatory practice is prohibited by the act.[84]

In 1992 the Tenth Circuit addressed two issues affecting ADEA claims. In *Oestman v. National Farmers Union Insurance Co.*,[85] the court clarified the analysis to be used in making the employee/independent contractor distinction in the ADEA context. In *Aronson v. Gressly*,[86] it considered whether the 240-day statute of limitation for filing a claim under Title VII[87] also applies to ADEA cases.

### A. Oestman v. National Farmers Union Insurance Co.: *Employee/ Independent Contractor Distinction*

Like Title VII, the Age Discrimination in Employment Act (ADEA) only protects *employees* from discriminatory treatment.[88] The statute de-

82. Aronson v. Gressly, 961 F.2d 907, 910 (10th Cir. 1992).

83. 29 U.S.C. § 621-634 (1988).

84. BARBARA L. SCHLEI & PAUL GROSSMAN, EMPLOYMENT DISCRIMINATION, 485 (2d ed. 1983).

85. 958 F.2d 303 (10th Cir. 1992).

86. 961 F.2d 907 (10th Cir. 1992).

87. 42 U.S.C. Secs. 2000e to 2000e-17 (1988). Specifically, the Title VII statute of limitation is found in section 2000e-5(e).

88. Regarding prohibited employer practices, the ADEA states:

> It shall be unlawful for an employer —
> (1) to fail or refuse to hire or to discharge any individual or otherwise discriminate against any individual with respect to his compensation, terms,conditions, or privileges of employment, because of such individual's age; . . . .

29 U.S.C. § 623(a) (1988). Almost identical language is found in Title VII:

> It shall be an unlawful employment practice for an employer —
> (1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin; . . . .

42 U.S.C. § 2000e-2(a) (1988).

fines "employee" as "an individual employed by an 'employer'."[89] Due to the ambiguity and circularity of this definition, the issue determining whether or not a plaintiff is an employee entitled to the protection of the act or is an unprotected independent contractor is a source of much litigation.[90]

In *Oestman* the Tenth Circuit tried to answer this question in the ADEA context. Plaintiff Oestman was an insurance agent with National Farmers[91] who filed suit in federal district court claiming a violation of the ADEA.[92] The trial court granted defendant's motion for summary judgment, ruling that the plaintiff was an independent contractor not subject to the protection of the Act.[93] On appeal, plaintiff argued that the trial court erred. Had the court applied the common law control doctrine in determining the plaintiff's employment status, it certainly would have denied defendant's summary judgment motion.[94]

The Tenth Circuit held that the proper test to evaluate the employment status of an ADEA plaintiff is not the common law control doctrine but the "hybrid test."[95] Although the hybrid test focuses on the employer's right to control the means and matter of the employment, similar to the common law "right to control" test, the hybrid test also takes into account the economic realities of the relationship.[96] The court relied upon the hybrid factors enumerated by the District of Columbia Circuit Court of Appeals in *Spirides v. Reinhardt*, a Title VII case:[97]

> (1) the kind of occupation, with reference to whether the work usually is done under the direction of a supervisor or is done by a specialist without supervision; (2) the skill required in the particular occupation; (3) whether the "employer" or the individual in question furnishes the equipment used and the place of

89. 29 U.S.C. § 630(f) (1988).

90. *See, e.g.*, Fields v. Hallsville Indep. Sch. Dist., 906 F.2d 1017 (5th Cir. 1990), *cert. denied*, — U.S. —, 111 S. Ct 676 (1991).

91. *Oestman*, 958 F.2d at 304.

92. *Id.* at 303.

93. *Id.* at 303-04.

94. *Id.* at 304. The common law control doctrine is best described by section 2 the Restatement of Agency which distinguishes servants from independent contractors:

> (1) A master is a principal who employs an agent to perform service in his affairs and who controls or has the right to control the physical conduct of the other in the performance of the service.
>
> (2) A servant is an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is *controlled or is subject to the right to control* by the master.
>
> (3) An independent contractor is a person who contracts with another to do something for him but who is not controlled by the other nor subject to the other's right to control with respect to his physical conduct in the performance of the undertaking. He may or may not be an agent.

RESTATEMENT (SECOND) OF AGENCY § 2 (1958) (emphasis added).

95. *Oestman*, 958 F. 2d at 305.

96. *Id.*

97. 613 F.2d 826 (D.C. Cir. 1979). In *Spirides*, a Title VII sex discrimination case, the plaintiff worked intermittently as a foreign language broadcaster for the Voice of America. Her contract stipulated that she was to work as an independent contractor. She was paid per assignment. She filed suit when her contract was not renewed. The trial court found that the plaintiff was an independent contractor and granted defendant's motion for summary judgment. The D.C. Circuit reversed and remanded. *Id.*

> work; (4) the length of time during which the individual has worked; (5) the method of payment, whether by time or by the job; (6) the manner in which the work relationship is terminated, i.e., by one or both parties, with or without notice and explanation; (7) whether annual leave is afforded; (8) whether the work is an integral part of the business of the "employer"; (9) whether the worker accumulates retirement benefits; (10) whether the "employer" pays social security taxes; (11) the intention of the parties.[98]

The Tenth Circuit, following the Third Circuit in *E.E.O.C. v. Zippo Manufacturing Co.*,[99] reasoned that because the substantive provisions of the ADEA mirrored those of Title VII, the hybrid test used in Title VII cases should be used to resolve the substantive question of what constitutes an employee as opposed to an independent contractor under the ADEA.[100] The court affirmed the summary judgment granted by the trial court holding that even under the hybrid test, the plaintiff was an independent contractor and therefore ineligible for ADEA protection.

### B. Aronson v. Gressly:[101] *Filing Periods*

The Tenth Circuit refused to extend the Title VII analogy to the procedural aspects of the ADEA. In *Aronson* the court held that the 240-day limitation provision for Title VII actions in deferral states[102] does not apply to ADEA cases.[103]

As in Title VII cases, ADEA charges must be filed with the Equal Employment Opportunity Commission within 180 days of the alleged discriminatory action.[104] Cases that arise in states that have similar statutes and agencies equipped to investigate age discrimination claims—

98. *Oestman*, 958 F.2d at 305 (quoting *Spirides*, 613 F.2d at 832).

99. 713 F.2d 32 (3d Cir. 1983).

100. *Oestman*, 958 F.2d at 305.

101. 961 F.2d 907 (10th Cir. 1992).

102. A deferral state is one which has enacted anti-discrimination legislation similar to Title VII which sets up a state equivalent of the EEOC charged with investigating unlawful employment practices. Title VII requires claimants under that statute to allow 60 days for the state equivalent agencies to attempt to resolve the dispute before it will receive a charge. 42 U.S.C. § 2000e-5(f)(1) (1988).

103. *Aronson*, 961 F.2d at 912. The *Aronson* court failed to recognize a recent step taken by Congress to draw a closer parallel between Title VII and the ADEA. Under the statute as originally enacted, ADEA actions had to be filled within two years of the adverse employment action except charges of willful violation of the act could be commenced within three years. 29 U.S.C. §§ 626(e), 255(a) (1988). However, in 1991, Congress amended the Act's limitation provision, making it substantially similar to the statute of limitation of Title VII. 29 U.S.C.A. § 626 (e) (West Supp. 1992); *see also Administration & Enforcement: ADEA suits*, 8 Fair Empl. Prac. Manual (BNA) 431:172 (1991).

104. The relevant section of ADEA states:

> (d) Filing of charge
> No civil action may be commenced by an individual under this section until 60 days after a charge alleging unlawful discrinmination has been filed with the Equal Employment Oppurtunity Commission. Such a charge shall be filed—
> (1) within 180 days after the alleged unlawful practice occurred; or. . . (2). . . within 300 days after the alleged unlawful practice occurred, or within 30 days after receipt by the individual of notice of termination of proceedings under State law, whichever is earlier.

29 U.S.C. Sec. 626(d) (1988).

known as deferral states—allow plaintiffs 300 days in which to file with the EEOC in order to provide the state agencies ample time to investigate and seek conciliation.[105] Once the administrative proceedings have terminated and the plaintiff is so notified, the plaintiff then has 90 days to file a civil action.[106]

The United States Supreme Court held in *Mohasco Corp. v. Silver*,[107] that in deferral states Title VII requires claimants to wait 60 days after the discriminatory practice before commencing their federal course of redress.[108] In effect, this 60-day window decreases the 300-day limit prescribed under Title VII to 240 days.[109] Because the ADEA also prescribed a 300-day limit for cases arising in deferral states, the court in *Aronson* was faced with the issue of whether or not the 60-day reduction imposed in *Mohasco* applied to ADEA cases as well.

In *Aronson*, the court noted the numerous similarities between Title VII and the ADEA. It reasoned that because the ADEA allowed claimants to file with the state before or after filing with the EEOC,[110] the 60-day waiting period of Title VII could not deducted from the 300-day statute of limitations of the ADEA.[111] Therefore, the 300-day limit set forth in the Act controlled the actions and Plaintiff's ADEA claim filed on day 246 was not time barred.[112]

### C. *Analysis*

Title VII and the ADEA are substantially similar in their substantive prohibitions of discrimination and the Tenth Circuit has joined other courts in holding that substantive ADEA issues can be resolved by analogy to Title VII precedent. The Tenth Circuit has adopted the Title VII framework to determine the method of proof required under the ADEA.[113] It is therefore logical that the analogy be used to determine other substantive questions, including how to make the employee/independent contractor distinction. It is sound judicial policy to utilize

105. *Id.* § 626(d)(2).

106. *Administartion & Enforcement: ADEA suits*, 8 Fair Empl. Prac. Manual (BNA) 431:172 (1991).

107. 447 U.S. 807 (1980).

108. *Mohasco Corp.*, 447 U.S. at 816-17 (citing 42 U.S.C. § 706(c)).

109. *Id.* at 814 n. 16; *see* SCHLEI & GROSSMAN, *supra* note 82, at 490.

110. *Aronson*, 461 F.2d at 911 (quoting Oscar Mayer & Co. v. Evans, 441 U.S. 750, 756 n.4 (1979)).

The court in *Aronson* took notice of the fact that under the ADEA the federal EEOC and the state equivalents are to exercise concurrent jurisdiction over age discrimination claims. In Title VII cases the state is granted a 60-day period of exclusive jurisdiction and, therefore, the claimants are prohibited from filing with the EEOC during such time. ADEA claimants, conversely, may file with the EEOC before or after the state has investigated the claim. Therefore, because claimants are not required to wait 60 days before filing with the federal agency, the 300-day limitation should not be reduced to 240 days as it is in Title VII deferral cases. *Id.*

111. *Id.*

112. *Id.* at 911-12

113. The court adopted the Title VII McDonnel Douglas/Burdine test of disparate treatment in the ADEA context in Branson v. Price River Coal Co., 853 F.2d 768 (10th Cir. 1988).

the substantive similarity of the statutes in order to avoid the accumulation of an entirely separate and often duplicative body of case law in order to interpret the ADEA.

There are, however, significant disparities between the procedural provisions of Title VII and the ADEA. Because the procedural aspects of the acts differ substantially, the analogy is less helpful in that area. The Supreme Court in *Oscar Mayer & Co. v. Evans*,[114] recognized that the concurrent administrative jurisdiction provisions were intentionally included by Congress to expedite the processing of age discrimination suits. Congress intended to give older Americans faster access to redress than was available under the sequential procedure of Title VII. "The premise for this difference is that the delay inherent in sequential jurisdiction is particularly prejudicial to the rights of 'older citizens to whom, by definition, relatively few productive years are left.' "[115]

Given the intentional differences in procedures, binding ADEA plaintiffs to the 240-day limitation period to which Title VII plaintiffs are bound would ignore the clear intent of the Congress.

## IV. CONCLUSION

In 1992, the Tenth Circuit Court of Appeals continued to erode public employees' rights by strictly interpreting the "property" provision of the Due Process Clause and creating a rudimentary baseline procedural requirement to satisfy constitutional demands. The court continued to delineate the analytical process to be used by courts in interpreting and applying the ADEA, borrowing the substantive case law of Title VII but correctly refusing to impose that statute's rigid procedural requirements on ADEA plaintiffs.

*Daniel Grossman*

114. 441 U.S. 750 (1979).
115. *Id.* at 757 (quoting 113 CONG. REC. 7076 (1967)(remarks of Sen. Javits)).

# ENVIRONMENTAL LAW SURVEY

## I. INTRODUCTION

In 1992, the Tenth Circuit addressed several issues certain to have a major impact on the evolution of environmental law. The court considered issues arising under: (1) the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA),[1] which continues to spawn expensive litigation as parties seek to impose financial responsibility on others for the cleanup of hazardous waste sites; (2) the Clean Water Act (CWA),[2] responsible for maintaining the integrity of the nation's waters; and (3) the National Environmental Policy Act (NEPA),[3] which mandates that federal agencies consider mitigation of adverse environmental effects before taking action.

This Article surveys select environmental cases decided by the Tenth Circuit. Part I discusses the issue of civil suits for medical monitoring expenses under CERCLA.[4] Part II discusses to what extent the Clean Water Act waives sovereign immunity for penalties in a civil action.[5] Part III evaluates the role of permit stipulations in an agency's decision to incorporate a mitigation discussion into its Environmental Impact Statement.[6]

## II. MEDICAL MONITORING UNDER CERCLA: *DAIGLE V. SHELL OIL CO.*[7]

### A. *Background*

CERCLA, commonly known as Superfund, deals with the cleanup of hazardous waste sites which pose a threat to public health and the environment.[8] The statute also provides for civil suits against the parties responsible for the hazardous waste, imposing liability on responsible parties for the costs of cleanup as well as "any other necessary costs of response incurred by any other person."[9] At issue in *Daigle* was whether provision for response costs extends to the creation of a "medical monitoring" or "medical surveillance" fund for those exposed to hazardous waste. Such a system would detect the onset of latent diseases caused by

1. 42 U.S.C. §§ 9601-9675 (1988 & Supp. 1990).
2. 33 U.S.C. §§ 1251-1387 (1988 and Supp. 1990).
3. 42 U.S.C. §§ 4321-4347 (1988).
4. *See* Daigle v. Shell Oil Co., 972 F.2d 1527 (10th Cir. 1992). *See also infra* text accompanying notes 7-73.
5. *See* Sierra Club v. Lujan, 972 F.2d 312 (10th Cir. 1992)(*Lujan II*). *See also infra* text accompanying notes 74-133.
6. *See* Holy Cross Wilderness Fund v. Madigan, 960 F.2d 1515 (10th Cir. 1992). *See also infra* text accompanying notes 134-182.
7. 972 F.2d 1527 (10th Cir. 1992).
8. 42 U.S.C. § 9604(a)(1) (1988) provides for remedial action "[w]henever (A) any hazardous substance is released or there is a substantial threat of such a release into the environment . . . or substantial threat of release . . . [of material dangerous] to the public health or welfare . . . ."
9. *See id.* § 9607(a)(4)(B).

toxic pollutants.[10]

1. Early Decisions

In *Brewer v. Ravan,*[11] the federal district court for the Middle District of Tennessee attempted to address the issue of medical monitoring costs within the scope of CERCLA. Former employees sued a capacitor manufacturer for exposure to contaminated soil. The defendants moved to dismiss for lack of subject matter jurisdiction, claiming that CERCLA did not contemplate medical monitoring liability.[12] The dismissal was denied. The court concluded that an action to recover costs for assessing the effects of a release of hazardous substances was a recognizable claim under CERCLA.[13] The court reasoned that because the term "response costs" also included costs incurred in the removal of toxic substances, medical testing was a legitimate cost involved in substance removal.[14] Little analysis was offered for this result other than the definitions supplied by CERCLA which provide for removal costs necessary to monitor a release.[15]

In *Coburn v. Sun Chemical Corp.,*[16] the federal district court for the Eastern District of Pennsylvania arrived at a conclusion in direct opposition to that of the *Brewer* court. The *Coburn* court examined in detail the response cost definitions supplied by CERCLA and considered them in light of earlier cases on similar matters.[17] The court began by acknowledging that CERCLA is inherently vague, finding that its definitions give little guidance and its legislative history is equally ambiguous.[18] The court searched prior decisions for guidance on the matter. For example, the *Coburn* court explained that, in *Exxon Corp. v. Hunt,*[19] the Supreme Court determined that Superfund money may not be used to "compensate private parties for *economic* harms that result from discharge of hazardous substances."[20]

The *Coburn* court also disagreed with the *Brewer* conclusion that medical monitoring tests fell within the range of response costs and concluded that the costs of medical screening were not "necessary costs of

10. *Daigle,* 972 F.2d at 1532-1533. Also at issue in *Daigle* was the "discretionary function exception" applicable to federal sovereign immunity jurisprudence, *id.* at 1537-43, and an ultrahazardous strict liability claim. *Id.* at 1543-45.

11. 680 F. Supp. 1176 (M.D. Tenn. 1988).

12. *Id.* at 1178.

13. *Id.* at 1179.

14. *Id.*

15. *Id.* (applying 42 U.S.C. § 9601(23)(1988)).

16. 1988 WL 120739 (E.D. Pa. Nov. 9, 1988).

17. *Id.* at *3-*5.

18. *Id.* at *2-*3.

19. 475 U.S. 355 (1986).

20. *Coburn,* 1988 WL 120739, at *3 (quoting *Exxon,* 475 U.S. at 375)(emphasis added)). The court contrasted this reasoning with that used in cases such as Jones v. Inmont Corp., 584 F. Supp. 1425 (S.D. Ohio 1984), in which medical testing apparently met the definition of "removal" expressed in CERCLA. However, the *Jones* court did not address the question of whether medical monitoring was one of the possible "necessary costs of response." Although the *Jones* decision did not attempt to clear this confusion, it did identify the problems involved in defining response costs. *Id.*

response."[21] The definition of the phrase merely contemplated the cleanup of hazardous substances.[22] The court also noted that legislative history showed that Congress intentionally repealed a provision to provide for recovery of medical expenses.[23] This indicated to the court that Congress did not intend to provide for medical expenses within CERCLA response costs.[24]

2. Recent Decisions

The extensive analysis given by the *Coburn* court set the stage for later decisions. *Werlein v. United States*[25] sought a monitoring fund, based on the response costs provision, to screen for early signs of disease stemming from exposure to toxic substances.[26] The court discussed both the *Brewer* line of cases as well as the cases following *Coburn*. The *Werlein* court found the *Coburn* line of cases persuasive,[27] and particularly emphasized the fact that CERCLA provided a medical care provision through the creation of the Agency for Toxic Substances and Disease Registry (ATSDR),[28] thus showing that Congress intended the medical costs to be provided through a separate system.[29]

A federal district court in *Ambrogi v. Gould, Inc.*[30] also followed the *Coburn* decision by holding that CERCLA response costs did not include provisions for medical monitoring.[31] The *Ambrogi* court recognized the emerging trend developing a consistent manner of dealing with medical monitoring under CERCLA.[32] Furthermore, the *Ambrogi* court asserted that, under the CERCLA definitions, "removal" actions only applied to activities designed to "affect the *threatened* release of hazardous substances."[33] Thus, once the release occurred, the statutory scope no longer considered such activities covered under the definition of removal actions.[34]

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21. *Id.*

22. *Id.*

23. A Legislative comment shows that Congress "deleted the Federal cause of action for medical expenses." 126 CONG. REC. 30,932 (1980).

24. *Coburn*, 1988 WL 120739, at *6.

25. 746 F. Supp. 887 (D. Minn. 1990), *vacated in part*, 793 F. Supp. 898 (D. Minn. 1992).

26. *Id.* at 901.

27. *Id.* at 903.

28. *Id.* The Agency for Taxic Substances and Diseased Registry was established by 42 U.S.C. § 9604(i) (1988).

29. *Id.*

30. 750 F. Supp 1233 (M.D. Pa. 1990).

31. *Id.* at 1246.

32. *Id.* at 1239. For a further examination of the development of medical monitoring, see Allan Kanner, Note, *Medical Monitoring: State and Federal Perspectives*, 2 TUL. ENVTL. L.J. 1 (1989). *See also* Dan A. Tanenbaum, Note, *When Does Going to the Doctor Serve the Public Health? Medical Monitoring Response Costs Under CERCLA*, 59 U. CHI. L. REV. 925 (1992).

33. *Ambrogi*, 750 F. Supp. at 1247 (emphasis in original).

34. *Daigle*, 972 F.2d at 1531.

B. *Tenth Circuit Decision*

1. Facts

The Rocky Mountain Arsenal (Arsenal) is a federally controlled CERCLA site near Commerce City, Colorado.[35] In 1956, the Army began using an area on the Arsenal known as Basin F to incinerate hazardous waste materials.[36] Shell Oil Company also used the basin to impound wastes generated in its herbicide and pesticide production facility.[37] The combination of the wastes created one of the most toxic hazardous waste sites in the country.[38] In 1984 the Army began a Remedial Investigation and Feasibility Study,[39] under which the Army identified Basin F as a site which needed an "Interim Response Action" to deal with the spread of contaminants from the site.[40] During the following year the Army transferred liquid hazardous wastes to on-site storage tanks and lined surface impoundments and moved solids into a lined waste pile, which was capped and then covered with top soil and vegetation.[41]

During this cleanup procedure, the plaintiffs complained of noxious odors and airborne pollutants being carried into their trailer park, located one-and-one-half miles from Basin F.[42] Residents allegedly suffered economic damage as well as a variety of physical ailments and the possibility of more serious latent diseases.[43] Under the CERCLA provision for "response costs," plaintiffs brought suit in federal district court for the District of Colorado to establish a long-term medical monitoring fund to detect any diseases that may be produced by exposure to the contaminants.[44] Shell Oil and the United States Government moved to dismiss the suit for lack of subject matter jurisdiction, claiming that response costs under CERCLA did not include medical monitoring.[45] The district court denied this and other motions and both parties sought interlocutory appeal. On appeal, the Tenth Circuit reversed in part, affirmed in part and remanded, concluding that medical monitoring costs

35. *Id.*.
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.* This study took place pursuant to 42 U.S.C. § 9604 (1988).
40. *Daigle*, 972 F.2d at 1532.
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.* at 1532-33. CERCLA provides that:

> any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable for—
>
> (A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan;
>
> (B) any other necessary costs of response incurred by any other person consistent with the national contingency plan . . . .

42 U.S.C. § 9607(a)(4) (1988).
45. *Daigle*, 972 F.2d at 1531.

were not included under CERCLA response costs.[46]

2. Holding

In reversing the district court's decision not to dismiss the medical monitoring charges, the Tenth Circuit concluded that the issue centered on the definition of "any other necessary costs of response."[47] The court decided that medical monitoring was not included in the definition. CERCLA does not directly define this phrase, rather, it only attempts to define the word "response." A "response" is defined by CERCLA as a removal action or a remedial action.[48] "Removal" is defined as the cleanup of already released hazardous substances from the environment.[49] These actions are designed to effect an interim solution to a contamination problem,[50] as opposed to "remedial actions," which are designed as permanent solutions to the contamination.[51] Implementation of remedial actions occurs instead of, or in addition to, removal actions.[52]

Plaintiffs in this case argued that a broad reading of the CERCLA language, — "other actions as may be necessary to prevent, minimize, or mitigate damage to the public health"[53] — within the definition of "removal" suggests that removal actions do include medical monitoring costs.[54] In support of this reading, the park residents relied primarily on *Brewer v. Ravan*,[55] which held that medical monitoring costs were included under CERCLA removal and remedial costs.[56]

The *Daigle* court decided that the *Brewer* interpretation was too far reaching and that the response cost provision of CERCLA did not contemplate medical monitoring costs.[57] Instead, the Tenth Circuit relied on the analysis given in *Coburn v. Sun Chemical Corp.*,[58] which rejected the

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46. *Id.* at 1537.

47. *Id.* at 1533. *See also* 42 U.S.C. § 9607(a)(4)(B) (1988).

48. "The terms respond or response means [sic] remove, removal, remedy, and remedial action . . . ." 42 U.S.C. 9601(25)(1988).

49. The terms 'remove' or 'removal' means [sic] the cleanup or removal of released hazardous substances from the environment, such actions as may be necessary taken in the event of the threat of release of hazardous substances into the environment, such actions as may be necessary to monitor, assess, and evaluate the release or threat of release of hazardous substances . . . .

*Id.* § 9601(23).

50. *Daigle*, 972 F.2d at 1533-34.

51. *Id.* at 1534. *See also* 42 U.S.C. § 9601(24) (1988).

52. 42 U.S.C. § 9601(24) (1988) provides:

The terms 'remedy' or 'remedial action' means [sic] those actions consistent with permanent remedy taken instead of or in addition to removal actions in the event of a release or threatened release of a hazardous substance into the environment, to prevent or minimize the release of hazardous substances so that they do not migrate to cause substantial danger to present or future public health or welfare or the environment.

53. *Daigle*, 972 F.2d at 1535.

54. *Id.*

55. 680 F. Supp. 1176 (M.D. Tenn. 1988).

56. *Id.* at 1179. *See also supra* text accompanying notes 11-15.

57. *Daigle*, 972 F.2d at 1535-36.

58. 1988 WL 120739 (E.D. Pa. Nov. 9, 1988). *See also supra* text accompanying notes 16-24.

*Brewer* analysis. In so doing, *Coburn* set the trend for most CERCLA medical monitoring cases to follow. The *Coburn* court based its decision on the plain meaning of the statute and concluded that CERCLA response costs did not extend to long-term medical monitoring costs.[59]

As had the court in *Werlein v. United States*,[60] the *Daigle* court also concluded that medical monitoring could not be used once a hazardous release occurs.[61] Because CERCLA defined remedial actions as actions used to prevent a release,[62] once a release occured, as in the *Daigle* case, the scope of CERCLA response costs no longer covered the type of long-term monitoring requested.[63]

The *Daigle* court found support for denying the medical monitoring action by pointing to the fact that CERCLA contains a provision for a type of medical monitoring.[64] CERCLA established the Agency for Toxic Substances and Disease Registry (ATSDR),[65] which allows individuals to petition for a health assessment and long-term health surveillance programs.[66] Despite the plaintiffs' argument that this provision indicate that CERCLA provides for medical monitoring expenses, the court decided that ATSDR does not extend a generalized adoption of medical monitoring to other CERCLA provisions.[67] As grounds for this conclusion, the court noted that the funding for ATSDR is separate from the funding for response costs.[68]

### C. *Analysis*

As the first federal appellate court to address directly the matter of medical monitoring costs under CERCLA,[69] this case will significantly influence future cases in other circuits. The *Daigle* decision adds little to the analyses developed by the lower federal courts in *Coburn* and *Ambrogi*. The *Daigle* court adopted the analysis of CERCLA definitions used by the *Coburn* court. This interpretation follows the structure of CERCLA and concludes that the private right of recovery for response costs does not include a right to costs for medical monitoring.[70] The *Daigle* court also adopted the analysis used by the *Ambrogi* court, as the circuit court concluded that long-term medical monitoring does not prevent

59. *Id.* at *6.
60. 746 F. Supp. 887 (D. Minn. 1990), *vacated in part*, 793 F. Supp. 898 (D. Minn. 1992).
61. *Daigle*, 972 F.2d at 1535.
62. 42 U.S.C. § 9601(24) (1988).
63. *Id.* at 1535-36.
64. *Daigle*, 972 F.2d at 1536-37.
65. 42 U.S.C. § 9604(i) (1988).
66. *Id.* § 9604(i)(6)(B).
67. *Daigle*, 972 F.2d at 1537.
68. *Id.* For a discussion of the role of ATSDR within CERCLA as well as its many inherent problems, see Martin R. Siegel, *Integrating Public Health Into Superfund: What Has Been the Impact of the Agency for Toxic Substances and Disease Registry?*, 20 ENVTL. L. REP. 10013 (1990).
69. *Daigle*, 972 F.2d at 1533.
70. *Id.* at 1535.

contact between a hazardous substance and the public.[71] Once a release occurrs, monitoring is no longer within the scope of response costs.[72]

While the *Daigle* decision may add nothing new to the trend emerging in the lower courts, it does solidify and refine the law by compiling the persuasive arguments from prior decisions. As noted in *Ambrogi*, the law on this issue is slowly developing a certain consistency.[73] The Tenth Circuit gave the *Coburn* and *Ambrogi* decisions enough emphasis to establish a lasting degree of clarity in this previously murky area of law.

## III. Sovereign Immunity under the Clean Water Act: *Sierra Club v. Lujan* (Lujan II)[74]

### A. *Background:* Sierra Club v. Lujan *(Lujan I)*[75]

The Tenth Circuit originally held in *Sierra Club v. Lujan* (Lujan I) that the Clean Water Act (CWA) waived sovereign immunity for civil penalties.[76] Normally, the United States is immune from any suit in the absence of consent. A waiver of sovereign immunity "must be unequivocally expressed" by Congress.[77] Courts are also required to strictly construe a waiver and not extend it beyond the language of the statute.[78] However, the CWA exposed the federal government to liability through section 1323 of the Act.[79]

*Lujan I* involved a citizen suit concerning alleged violations of a CWA permit at the Leadville tunnel in Lake County, Colorado.[80] Section 1365(a) allows citizens to bring suit against the United States for violations of the CWA.[81] The statute also gives federal district courts jurisdiction over these matters and allows them to "apply any appropriate civil penalties under section 1319(d) of this title."[82] The court determined that section 1319(d), which authorizes civil penalties for CWA violations,[83] could be applied because a permit for the tunnel had been

71. *Id.*
72. *Id.*; *see also supra* text accompanying notes 30-34.
73. *Ambrogi*, 750 F. Supp. at 1239.
74. 972 F.2d 312 (10th Cir. 1992).
75. 931 F.2d 1421 (10th Cir. 1991).
76. *Id.* at 1429.
77. *Id.* at 1423 (quoting United States v. Testan, 424 U.S. 392, 399 (1976)).
78. *Id.* (citing Ruckelshaus v. Sierra Club, 463 U.S. 680, 686 (1983)).
79. 33 U.S.C. § 1323(a) states that "[e]ach department, agency, or instrumentality . . . shall be subject to, and comply with, all Federal, State, interstate, and local requirements, administrative authority, and *process and sanctions* respecting the control and abatement of water pollution in the same manner, and to the same extent as any nongovernmental entity . . . ." (emphasis added).
80. *Lujan I*, 931 F.2d at 1422.
81. Section 1365(a)(1) allows any citizen to file suit "against any person (including (i) the United States, and (ii) any other governmental instrumentality or agency to the extent permitted by the eleventh amendment to the Constitution) who is alleged to be in violation of (A) an effluent standard or limitation under this chapter . . . ." 33 U.S.C. § 1365(a)(1) (1988).
82. *Id.* § 1365(a)(2).
83. For violations of the CWA:
> Any *person* who violates section 1311, 1312, 1316, 1317, 1318, 1328, or 1345 of this title, or any permit condition or limitation implementing any of such sections in a permit issued under section 1342 of this title by the Administrator, or by a

issued by the EPA under section 1342.[84]

The court examined section 1323(a) to determine the extent to which the federal government is liable for civil penalties. The section states that "the United States shall be liable only for those civil penalties arising under *Federal law* or imposed by a State or local court to enforce an order or the process of such court"[85] Finally, the court looked to section 1362 of the CWA for the definition of "person." The section defines person as "an individual, corporation, partnership, association, State, municipality, commission, or political subdivision of a State, or any interstate body."[86]

The main issue in *Lujan I* was whether the term "sanctions" in the section 1323(a) phrase "process and sanctions" encompassed "civil penalties" under Section 1319(d).[87] The court held that the CWA clearly authorized courts to assess civil penalties against federal agencies,[88] and decided that "sanctions" encompassed civil penalties as provided in sections 1365 and 1319.[89]

The United States Department of the Interior and the United States Bureau of Reclamation[90] urged the court to view "sanctions" as including only coercive sanctions.[91] Coercive sanctions may be used to force agency compliance with a court order.[92] The agencies argued against including punitive sanctions designed to punish an agency for past noncompliance.[93] However, the agencies cited only *McClellan Ecological Seepage Situation v. Weinberger*[94] to defend this position, which concluded that Congress had not unambiguously waived sovereign immunity for punitive fines. The *Lujan I* court pointed out that *McClellan*, however, is an isolated case and that many courts have held that the CWA does waive sovereign immunity for punitive fines.[95]

The *Lujan I* court also rejected the defendants' argument that the CWA generally excludes the federal government as a person for the purpose of assessing penalties.[96] Because section 1365 states that a civil

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State . . . shall be subject to a *civil penalty* not to exceed $25,000 per day for each violation . . . .

33 U.S.C. 1319(d) (1988) (emphasis added).

84. *Lujan I*, 931 F.2d at 1424.

85. 33 U.S.C. § 1323(a)(2)(C) (1988) (emphasis added).

86. *Id.* § 1362(5).

87. *Lujan I*, 931 F.2d at 1425.

88. *Id.*

89. *Id.*

90. The United States Dept. of the Interior and the United States Bureau of Reclamation jointly own and operate the Leadville tunnel and are both subject to the CWA permitting regulations. *Id.* at 1422.

91. *Id.*

92. *Id.* at 1425.

93. *Id.*

94. 655 F. Supp. 601 (E.D. Cal. 1986).

95. *Lujan I*, 931 F.2d at 1425. *See* Ohio v. United States Dep't of Energy, 904 F.2d 1058 (6th Cir. 1990), *rev'd*, 112 S. Ct. 1627 (1992); Metropolitan Sanitary Dist. v. United States Dep't of Navy, 722 F. Supp. 1565 (N.D. Ill. 1989), *dismissed in part*, 737 F. Supp. 51 (1990); California v. United States Dep't of Navy, 631 F. Supp. 584 (N.D. Cal. 1986), *aff'd*, 845 F.2d 222 (9th Cir. 1988).

96. *Lujan I*, 931 F.2d at 1426-27.

suit may be brought against "any citizen (including . . . the United States)", Congress showed an express desire to waive sovereign immunity for civil actions under the CWA.[97]

### B. *Supreme Court Action*

The question in *United States Dep't of Energy v. Ohio*[98] parallels the issue in *Lujan II*. The state of Ohio sought punitive fines from the Department of Energy for past violations of the CWA.[99] The lower court held that the CWA waived sovereign immunity for punitive fines and the Supreme Court reversed.[100] The Court distinguished punitive fines from coercive fines, holding that while the CWA waived sovereign immunity for coercive fines,[101] Congress did not explicitly waive sovereign immunity for punitive fines.[102]

While the Court analyzed the same important issues as had the *Lujan I* court, it arrived at an opposite conclusion in each instance. The Court found that the overall goal of the CWA excluded the United States from the definition of "person."[103] Although the section 1365 civil suit provision of the CWA included the United States in the definition of person,[104] it was not included as such in the section 1362 definition of person, nor under the section 1323(a) federal facilities pollution control provisions.[105] The Court inferred from this that Congress intended the United States to be deemed a person only when explicitly stated by statute.[106]

The Court then concluded that the section 1323(a) waiver of sovereign immunity for "process and sanctions" did not include a waiver for punitive fines.[107] The Court offered no persuasive authority for this conclusion and ignored the developing trend in the lower courts to include a waiver of sovereign immunity for punitive fines.[108] Nevertheless, the Court clearly stated that, through its own narrow construction of the statute, sovereign immunity was "waiv[ed] no further than the coercive variety."[109] This ruling effectively overruled the *Lujan I* decision and allowed the agencies to appeal the original Tenth Circuit decision. Later, the Supreme Court vacated *Lujan I* and remanded for further consideration.[110]

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97. *Id.* at 1427.
98. 112 S. Ct. 1627 (1992).
99. *Id.* at 1632.
100. *See* United States Dep't of Energy v. Ohio, 112 S. Ct. 1627 (1992).
101. *Id.* at 1634-35.
102. *Id.* at 1634.
103. *Id.*
104. *Id.* at 1635 n.14.
105. *Id.* at 1635.
106. *Id.*
107. *Id.* at 1639.
108. *See id.*
109. *Id.*
110. Lujan v. Sierra Club, 112 S. Ct. 1927 (1992).

### C. Sierra Club v. Lujan *(Lujan II)*[111]

#### 1. Facts

The Department of the Interior and the Bureau of Reclamation own and operate the Leadville tunnel, located in Lake County, Colorado. In 1975, the EPA issued to the Bureau of Reclamation a National Pollution Discharge Elimination System (NPDES)[112] permit authorizing the discharge of pollutants.[113] The EPA reissued the permit several times.[114]

On January 13, 1989, the Sierra Club along with the Colorado Environmental Coalition filed a complaint in federal district court alleging the Interior Department and Bureau of Reclamation violated the 1975 NPDES permit.[115] The plaintiffs asked the court to: (1) issue a mandatory injunction enjoining further permit violations; (2) order the agencies to pay civil penalties; and (3) declare that the agencies were in violation of the CWA.[116] The defendant agencies moved to dismiss the civil penalties claim for lack of subject matter jurisdiction, arguing that the CWA did not waive sovereign immunity for civil penalties.[117] The district court denied the agencies' motion and certified the question of civil penalties for interlocutory appeal to the Tenth Circuit Court of Appeals.[118]

#### 2. Opinion

On remand from the Supreme Court, the Tenth Circuit court was forced to follow the Supreme Court analysis in *United States Department of Energy v. Ohio* and reverse its original holding in *Lujan I*. The *Lujan II* court reiterated the Court's arguments pertaining to the definition of the phrase "process and sanctions." It quoted the Court's language that "[t]he very fact . . . that the [section 1323(a)] text speaks of sanctions in the context of enforcing 'process' as distinct from substantive 'requirements' is a good reason to infer that Congress was using 'sanction' in its coercive sense, to the exclusion of punitive fines."[119]

The *Lujan II* court next addressed the problem of the 1323(a) provision subjecting the United states to liability "only for those civil penalties arising under Federal law or imposed by a State or local court to enforce an order or the process of such court."[120] While the first part of the phrase indicates that civil penalties may also include punitive fines, the latter part seems to deal only with fines used to enforce a court order—coercive fines. The *Lujan II* court followed the *United States Dep't Of*

111. 972 F.2d 312 (10th Cir. 1992).
112. 33 U.S.C. § 1342 (1988).
113. *Lujan II*, 972 F.2d at 313.
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.* at 312.
118. *Id.* at 312-13.
119. *Id.* at 315 (quoting United States Dep't of Energy v. Ohio, 112 S. Ct. 1627, 1637 (1992)).
120. 33 U.S.C. § 1323(a)(2)(C) (1988); *Lujan II*, 972 F.2d at 315.

*Energy v. Ohio* analysis and resolved this tension through "the requirement that any statement of waiver be unequivocal,"[121] holding that the CWA did not waive sovereign immunity for punitive fines.[122]

D. *Analysis*

The Sierra Club attempted to distinguish *United States Dep't of Energy v. Ohio* from the facts in *Lujan II* case by arguing that the former case involved alleged violations of a state-issued permit[123] while *Lujan II* involved a permit issued directly by the EPA.[124] The Sierra Club argued that because the permit was issued by a federal agency, it was within the scope of the CWA section 1323(a) provision subjecting the United States to liability "for those penalties arising under Federal law."[125] The *Lujan II* court summarized the Sierra Club argument as stating that "when the government has violated a permit issued directly by EPA 'under federal law,' any confusion regarding the waiver of sovereign immunity in section 1323(a) disappears."[126]

Such an argument is possible because the Court in *United States Dep't of Energy v. Ohio* held that "Ohio's argument for treating state-penalty provisions as arising under federal law . . . fails."[127] The Court thus appeared to make a distinction between a state-issued permit and a permit issued directly by a federal agency. Such an implied distinction leaves unanswered the actual meaning of the phrase "civil penalties arising under federal law."[128] The Court speculated on possible reasons for inclusion of the phrase in the statute, but concluded its discussion by stating that the "question has no satisfactory answer."[129]

The Tenth Circuit was in a position to carve out an exception to the holding in *United States Dep't of Energy v. Ohio* by affirming the district court decision. Rather than doing so, the court read the Supreme Court's ambivalence broadly and concluded that *United States Dep't of Energy v. Ohio* stood for the proposition that "Congress did not legislate an unequivocal waiver of sovereign immunity regarding the assessment of punitive civil penalties against the United States under the Clean Water Act."[130]

While a disappointing decision for environmental groups, the court's decision nonetheless is a rather magnanimous attempt at creating uniformity and clarity on this issue. The Tenth Circuit gave no discussion of the fact that the Supreme Court decision in *United States Dep't*

121. *Lujan II*, 972 F.2d at 316 (quoting United States Dep't of Energy v. Ohio, 112 S. Ct. at 1639).
122. *Id.* at 316.
123. *United States Dept. of Energy v. Ohio*, 112 S. Ct. at 1632.
124. *Lujan II*, 972 F.2d at 316.
125. 33 U.S.C. § 1323(a)(2)(C) (1988).
126. *Lujan II*, 972 F.2d at 316.
127. *United States Dept. of Energy v. Ohio*, 112 S.Ct at 1639.
128. *Id.*
129. *Id.*
130. *Lujan II*, 972 F.2d at 316.

*of Energy v. Ohio* created a roadblock in the path taken by this area of law, which demanded a complete reversal of the circuit's past direction.

Sierra Club made a valid argument based on the "analytic gymnastics"[131] the Supreme Court performed to arrive at its conclusion. The Tenth Circuit indicated that a uniform approach was more important than a further fragmentation of the issue. Thus, the new direction of law on this issue appears relatively settled, even if in direct opposition to precedent. The court concluded that whether a CWA permit is issued by a state or by the EPA, "the result is the same—no waiver of sovereign immunity."[132]

Unless Congress disagrees with this new interpretation and clarifies the CWA, this new direction in the law will ultimately present federal agencies with more opportunities to use their own discretion. Under *Lujan II,* federal agencies are shielded completely from punitive fines for violations of the CWA. Fines will not accrue, and the agencies will not be threatened until a court order is actually imposed, making coercive fines a real possibility.[133] Although the Supreme Court disagreed with the argument that punitive fines were necessary deterrents, the fact remains that a significant tool capable of forcing agencies to comply with the Clean Water Act has been lost.

## IV. NATIONAL ENVIRONMENTAL POLICY ACT: *HOLY CROSS WILDERNESS FUND V. MADIGAN*[134]

### A. BACKGROUND

The Homestake II project is a long-term water development plan designed to provide the Colorado cities of Colorado Springs and Aurora (Cities) with additional water.[135] The project involves diverting water from Cross Creek and Fall Creek in the Holy Cross Wilderness Area to the Homestake Reservoir through a series of diversions and underground tunnels.[136] In 1982, the Cities sought a land use easement from the Forest Service, requiring it to conduct an environmental analysis.[137] The Forest Service prepared a draft Environmental Impact Statement (EIS) analyzing six project alternatives and conducted twenty public

131. *United States Dep't of Energy v. Ohio,* 112 S.Ct at 1641 (White, J., dissenting).

132. *Lujan II,* 972 F.2d at 316.

133. *United States Dept. of Energy v. Ohio,* 112 S. Ct. at 1638. Plaintiff State of Ohio argued that the purpose of punitive fines was "to encourage compliance with comprehensive, federally approved water pollution programs . . . . [F]ederal facility compliance . . . cannot be . . . accomplished without the [punitive] penalty deterrent." *Id.*

134. 960 F.2d 1515 (10th Cir. 1992).

135. *Id.* at 1518.

136. *Id.* The Wilderness Area is managed under the Wilderness Act, 16 U.S.C. § 1131-1136 (1988). However, due to Congressional intent, the Homestake II project is exempt from the Wilderness Act's ban on water projects. *Id.* § 1133(4).

137. *Holy Cross,* 960 F.2d at 1518. An environmental analysis is a detailed statement of environmental impact required by the National Environmental Policy Act ("NEPA") for any "major Federal actions significantly affecting the quality of the human environment . . . ." 42 U.S.C. 4332(2)(C) (1988). Environmental Impact Statements are submitted to the Council on Environmental Quality (CEQ) before regulations are promulgated. *Id.*

hearings on the water project.[138]

In 1983, the Forest Service completed its final EIS, concluding that the Homestake II project would not significantly impact wetlands or other environmental areas.[139] With this finding, the Forest Service issued its Record of Decision[140] and granted a land use easement. Once the land use easement had been obtained, the cities next sought a dredge and fill permit from the Army Corps of Engineers.[141] Rather than automatically adopting the Forest Service's final EIS, the Corps conducted an independent review of that statement.[142] The Corps concluded that the Forest Service had not adequately shown that there would be no wetlands damage.[143]

The Corps then hired an independent consultant, Aqua Resources, Inc. (ARI), to study the wetlands impact.[144] In 1984, ARI's report indicated a potential for wetlands harm.[145] ARI recommended undertaking additional studies, requiring pre- and post-construction monitoring and implementation of measures if deemed necessary by the additional studies.[146] The Environmental Protection Agency (EPA) then reviewed the ARI study and concluded that additional studies should be considered before construction of the water diversion project.[147]

Disregarding the advice of ARI as well as the EPA, the Corps chose not to conduct additional studies, nor did it prepare its own EIS.[148] Rather, it adopted the Forest Service EIS and issued a dredge and fill permit subject to specific conditions requiring the Cities design a plan that would prevent wetlands damage in the wilderness area.[149] The permit specifically stated that "the applicants shall prevent the loss of wetlands."[150]

In compliance with this permit condition, the Cities prepared a nine volume wetlands report and mitigation plan which provided for extensive, long-term monitoring as well as a detailed mitigation plan to prevent wetlands losses and concluded that no wetlands loss would

138. *Holy Cross*, 960 F.2d at 1518.

139. *Id.* at 1519.

140. *Id.*

141. *Id.* A dredge and fill permit is required "for the discharge of dredged or fill material into the navigable waters at specified disposal sites." 33 U.S.C. § 1344(a) (1988).

142. *Holy Cross*, 960 F.2d at 1519.

143. *Id.* Meanwhile, the United States Fish and Wildlife Service had conducted a review and concluded that there would be no detrimental impact on wetlands. *Id.*

144. *Id.*

145. *Id.* The report concluded that "[t]here is a potential for significant adverse impacts to downstream wetlands in terms of sequentially (over time) lowering the water table associated with several Cross and Fall creek wetlands." *Id.*

146. *Id.* at 1520.

147. *Holy Cross*, 960 F.2d at 1520.

148. *Id.*

149. *Id.*

150. *Id.* In the Record of Decision, the Army Corps District Engineer stated, as rationale for issuing the permit but only with the condition, "I intend that these wetlands be preserved, but I do not wish to unnecessarily prolong the permitting process or restrict the City's [sic] development of their water rights." *Id.*

occur.[151] The Corps approved this plan in 1988.[152]

The Holy Cross Wilderness Fund filed suit in 1985 to set aside the land use easement as well as the dredge and fill permit, claiming that both violated NEPA.[153] After trial, the district court concluded that the Corps did not violate NEPA or any other law. Holy Cross Wilderness Fund then appealed.[154]

B. *The Tenth Circuit Opinion*

On appeal, the Tenth Circuit agreed that there were no violations of NEPA. The Forest Service final EIS was properly adopted by the Corps and the Corps' need to seek additional information concerning the reasonably foreseeable significant adverse impacts was obviated by the Corps' decision to issue the permit with the condition that no wetlands losses occur.[155]

The court examined separately the issues of the EIS adoption and permit conditions. First, the court held that the Corps could adopt the Forest Service final EIS rather than complete another unless it found substantial doubt as to the adequacy of the final EIS.[156] Under these guidelines the court then looked to the adequacy of the original Forest Service final EIS. The court could not find that the final EIS, which addressed the impact of the water project on wetlands, lacked a "reasonable, good faith, objective presentation" of adverse environmental effects.[157] The court then decided that the lack of a *detailed* mitigation plan stemmed from the Forest Service's initial decision that the project would not adversely effect any wetlands areas.[158] The Forest Service was under no obligation to create a mitigation plan for adversities it did not anticipate.[159]

Second, the court examined the Fund's argument that the Corps erred in deciding not to supplement the final EIS after learning from ARI that additional data were needed.[160] Because experts disagreed on this issue, the court felt it best to defer to the discretion of the agency.[161] Thus, the court refused to second-guess the agency and

151. *Id.*
152. *Id.*
153. *Id.* at 1521.
154. *Id.*
155. *Id.* at 1526.
156. *Id.* An agency may adopt a Federal draft or final environmental impact statement or portion thereof provided that the statement or portion thereof meets the standards for an adequate statement under these regulations. *Id.* at 1522; 40 C.F.R. § 1506.3(a) (1992).
157. *Holy Cross*, 960 F.2d at 1526 (quoting Johnston v. Davis, 698 F.2d 1088, 1091 (10th Cir. 1983)). Judicial examination is "performed for the limited purpose of ensuring that the document is a good faith, objective, and reasonable explanation of environmental consequences that responds to the five topics of NEPA's concern." *Johnston*, 698 F.2d at 1091.
158. *Holy Cross*, 960 F.2d at 1526-27.
159. *Id.*
160. *Id.* at 1526. The court also addressed the Fund's arguments under the CWA. *See id.* at 1524-25 & 1527-29.
161. *Id.* at 1527. The Madigan court cited Marsh v. Oregon Natural Resources Council, 490 U.S. 360, 378 (1988), which stated that when "specialists express conflicting views,

could find no basis for holding that the Corps' decision lacked a reasoned evaluation of the new information.[162] The court found this especially true in light of the fact that the Corps issued the permit with the stipulation that no wetlands losses occur.[163] This condition apparently obviated the need for the Corps to prepare a supplemental EIS.[164]

C. *Analysis*

NEPA requires that a federal agency considering a major action prepare an EIS.[165] Under these guidelines the agency is required to discuss ways to mitigate adverse environmental consequences.[166] However, "it is 'well settled that NEPA itself does not mandate particular results, but simply prescribes the necessary process.' "[167] *Robertson v. Methow Valley Citizens Council*[168] discussed the fact that as long as the agency adequately identified and evaluated the adverse effects of an action, it may decide that other values outweigh the environmental effects.[169] However, the Court did not minimize the significance of the discussion of mitigation measures. The Court labeled them an "important ingredient of an EIS."[170]

The Tenth Circuit in *Holy Cross* dealt with a slightly more refined issue than did the Supreme Court in *Robertson*. The Fund argued that the Corps erred in adopting the Forest Service final EIS which did not contain a detailed mitigation plan. Under a strict application of *Robertson*, this appears to be a compelling argument. However, the *Holy Cross* court distinguished *Robertson* by showing Forest Service's initial conclusion that there would be no adverse effect on wetlands obviated the

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an agency must have discretion to rely on the reasonable opinions of its own qualified experts even if, as an original matter, a court might find contrary views more persuasive." *Id.*

162. *Id.*

163. *Id.*

164. Section 4332 of NEPA provides:

> [T]o the fullest extent possible . . . (2) all agencies of the Federal Government shall . . .
> (C) include in every recommendation or report on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment, a detailed statement by the responsible official on —
> (i) the environmental impact of the proposed action,
> (ii) any adverse environmental effects which cannot be avoided should the proposal be implemented,
> (iii) alternatives to the proposed action,
> (iv) the relationship between local short-term uses of man's environment and the maintenance and enhancement of long-term productivity, and
> (v) any irreversible and irretrievable commitments of resources which would be involved in the proposed action should it be implemented . . . .

42 U.S.C. § 4332 (1988).

165. *Id.* § 4332(c) (1988).

166. *Id.*

167. *Holy Cross*, 960 F.2d at 1522 (quoting Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 350 (1989)).

168. 490 U.S. 332 (1989).

169. *Id.* at 350.

170. *Id.* at 351. The Court proceeded to state that an "omission of a reasonably complete discussion of possible mitigation measures would undermine the 'action-forcing' function of NEPA." *Id.* at 352.

need to prepare a detailed mitigation plan.[171]

This conclusion presents a potentially large problem in challenging agency actions under NEPA. While agencies are under no obligation to adopt a mitigation plan, a discussion of such plans in the EIS is required.[172] The Tenth Circuit avoided a reversal of the Forest Service and Corps actions due to the lack of a detailed mitigation discussion in the Forest Service final EIS in two ways. First, the court deferred to the agency's judgment because of the conflicting opinions of experts.[173] Second, and most significantly, the court pointed to the fact that the Corps issued the dredge and fill permit with the stipulation that no wetlands loss occur.[174] The court concluded that, due to this stipulation, "the Corps no longer needed to evaluate 'reasonably foreseeable significant adverse impacts' on wetlands, because [the Corps] *assumed* such impacts [would occur] and essentially guaranteed that the Cities mitigate those impacts."[175] Under this analysis, the court held that there were no NEPA violations.[176]

Leaving aside the court's deference to the agencies, the court's acceptance of the Corps' permit stipulation presents two problems. In this instance the agency concluded that its actions presented no threat of loss to wetlands and yet also *assumed* that some adverse impacts were inevitable. With this type of awkward logic, it seems clear under the ruling in *Robertson* that a detailed mitigation discussion is required in a final EIS.[177] Also, the court overlooked the fact that *Robertson* does not require a mitigation plan merely for environmental loss, but focuses instead on "adverse environmental effects."[178]

Second, this reasoning leaves open the question of what agencies must do in similar future cases. The court's language suggests that a

171. *Holy Cross*, 960 F.2d at 1526.

172. *Robertson*, 490 U.S. at 351. *See, e.g.*, Kleppe v. Sierra Club, 427 U.S. 390, 410-11 (1976); Natural Resources Defense Council, Inc. v. Morton, 458 F.2d 827, 838 (D.C. Cir. 1972).

173. *Holy Cross*, 960 F.2d at 1527.

174. *Id.* at 1526.

175. *Id.* (emphasis in original).

176. *Id.*

177. Robertson v. Methow Valley Citizens Council, 490 U.S. 332, 351 (1989). *Robertson* held that "[i]mplicit in NEPA's demand that an agency prepare a detailed statement on 'any adverse environmental effects which cannot be avoided should the proposal be implemented' . . . is an understanding that the EIS will discuss the extent to which adverse effects can be avoided." This rationale is supported by the CEQ implementing regulations which define mitigation to include:

> (a) Avoiding the impact altogether by not taking a certain action or parts of an action.
> (b) Minimizing impacts by limiting the degree or magnitude of the action and its implementation.
> (c) Rectifying the impact by repairing, rehabilitating, or restoring the affected environment.
> (d) Reducing or eliminating the impact over time by preservation and maintenance operations during the life of the action.
> (e) Compensating for the impact by replacing or providing substitute resources or environments.

40 C.F.R. § 1508.20 (1992).

178. *Robertson*, 490 U.S. at 351.

stipulation attached to a permit will substitute for an adequate mitigation discussion in the agency's final EIS. This reasoning seems contrary to the goals of NEPA and the accepted interpretation of those goals as enunciated through cases such as *Robertson*.

The decision further constricts an already narrow standard of judicial review for finding an agency action "arbitrary and capricious."[179] The Tenth Circuit showed it was willing to defer to an agency decision with little inquiry into that agency's rationale. While the arbitrary and capricious standard is narrow, the court should not automatically defer as a general rule.[180] The facts showed that the Forest Service found there would be no wetlands loss, while independent experts and the Corps' District Engineer in his Record of Decision found a significant possibility for such adverse impacts.[181] While the court clearly may not substitute its judgment for that of an agency,[182] the court must undergo a review of the agency's decision. Such an inquiry was clearly lacking in *Holy Cross*. Such lack of evaluation leaves unclear whether the agency use of permit stipulations may substitute for EIS mitigation discussions in the future.

## V. CONCLUSION

In *Holy Cross*,[183] the Tenth Circuit again showed itself to be extremely willing to defer to federal agencies under the *Chevron* rule.[184] The Supreme Court reinforced this deference in *United States Department of Energy v. Ohio*,[185] which compelled the Tenth Circuit to reconsider its earlier holding in *Lujan I*.[186] The *Lujan II* court reversed *Lujan I*, refusing to carve out an exception. By so doing, the court further extended substantial judicial deference to federal agency decisions. *Holy Cross* portrayed the court as willing to defer to the agency without undergoing a proper analysis of the federal agency's reasoning. This lack of inquiry seems inconsistent with the Supreme Court's ruling that the courts should make an independent inquiry into the agency's interpretations to ensure that the agency's decision was reasonable. In *Daigle*,[187] the court solidified the direction of lower courts on the issue of medical response costs. The *Daigle* holding strengthens the emerging trend that CERCLA

179. *See* Chevron, USA Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842 (1984).

180. The court should not automatically defer to the agency's express reliance without carefully reviewing the record and satisfying themselves that the agency has made a reasoned decision. Marsh v. Oregon Natural Resources Council, 490 U.S. 360, 378 (1989).

181. *Holy Cross*, 960 F.2d at 1527.

182. *See Marsh*, 490 U.S. at 378.

183. *Holy Cross*, 960 F.2d at 1515.

184. Chevron USA Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984). *See* Robert D. Comer et al., Note, *Recent Developments in Environmental and Natural Resources Law*, 69 DENV. U. L. REV. 997, 1017 (1992).

185. 112 S. Ct. 1627 (1992). *See supra* text accompanying notes 98-109.

186. 931 F.2d 1421 (10th Cir. 1991). *See supra* text accompanying notes 76-97.

187. Daigle v. Shell Oil Co., 972 F.2d 1527 (10th Cir. 1992).

response costs do not extend to medical monitoring for past exposure to hazardous materials.

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# INTELLECTUAL PROPERTY SURVEY

## I. INTRODUCTION

The Supreme Court and Tenth Circuit addressed the modern intellectual property rights of trade dress, patent reexaminations and unique copyright damages during 1992. First, the Supreme Court streamlined the test for trade dress protection in deciding its first substantive trade dress case. Second, after Congress developed an additional patent challenge proceeding, the Tenth Circuit enumerated duties this new procedure requires. Third, the Tenth Circuit awarded the unique copyright damages of research and development costs for copyright infringement. This survey addresses the Tenth Circuit's approach to these three areas of intellectual property.

## II. TRADE DRESS: SECONDARY MEANING NOT REQUIRED IF INHERENTLY DISTINCTIVE

Trade dress refers to the overall image of a product, its packaging and the manufacturer's choice of visual design. Federal courts of appeal disagreed as to the proper test allowing protection for trade dress. The Supreme Court in its first decision concerning this exploding new area of law[1] clarified that test. In doing so the Court placed the developing law of trade dress squarely within the well-established law of trademarks despite their differences.

### A. *Background*

Historically, trade dress infringement claims developed under federal trademark and unfair competition law.[2] The conduct controlled by the two areas differs more in degree than in kind.[3] Under unfair competition, the total image creating consumer confusion must be modified upon a finding of infringement.[4] In contrast, under trademark law a court focuses on the discrete elements of plaintiff's marketing image.[5]

The Lanham Act was the first major step toward substantive federal trademark and unfair competition legislation in the United States.[6] The Act defines a trademark as any word, name, symbol, or device, or combination used to identify and distinguish a person's goods and to indicate the source of such goods.[7] A trademark can only be registered if it dis-

1. Two Pesos, Inc. v. Taco Cabana, Inc., 112 S. Ct. 2753 (1992).
2. Scott H. Culley & Ezekiel J. Williams, *Trade Dress: An Overview and Tenth Circuit Survey*, TRIAL TALK, July/Aug., 1992, at 181.
3. PAUL GOLDSTEIN, COPYRIGHT, PATENT, TRADEMARK AND RELATED STATE DOCTRINES 55 (3d ed. 1990).
4. *Id.*
5. *Id.*
6. Culley & Williams, *supra* note 2, at 181.
7. 15 U.S.C. § 1127 (1988).

tinguishes the applicant's goods from those in commerce.[8]

Registration affords the trademark owner several rights. First, it provides constructive notice of ownership,[9] thereby preventing subsequent people from acquiring any right to use that mark.[10] Second, any person using the same mark before registration has some rights against the registered owner but only in the specific territory the user occupied at the time of registration.[11] Third, after five consecutive years, a registered mark becomes immune from cancellation[12] and becomes incontestable.[13] Fourth, registration grants the owner an exclusive right to use the mark and establishes prima facie validity of the mark in any court proceeding.[14] Remedies are provided to protect the registrant of a registered mark including: (1) injunctive relief;[15] (2) recovery of profits, damages, costs and attorney fees;[16] and (3) destruction of the infringing articles.[17]

Registering a trademark requires a demonstration of the mark's distinctiveness and use in commerce. The former ensures that the mark identifies a single source of goods.[18] Judge Friendly articulated four well-accepted categories of distinctiveness: (1) generic; (2) descriptive; (3) suggestive; and (4) arbitrary or fanciful.[19] A generic term, such as "soap" or "bandage," cannot become a trademark under any circumstances.[20] Descriptive marks only describe the product such as "aloe soap" or "adhesive bandage." Descriptive marks are not distinct by definition, but must acquire distinctiveness through secondary meaning.[21] Secondary meaning occurs when a capacity to identify goods to a single source develops. Suggestive marks require a product's name to create an inference concerning the type of goods it represents.[22] An example is "Ivory Soap."[23] An inference exists between the color ivory and the purity of the soap. Fanciful and arbitray marks do not relate to the goods, such as "Dial Soap" or "Cutex Bandages." These marks never need a demonstration of secondary meaning to gain protection.[24]

The legal recognition of an inherently distinctive trademark or trade dress grants the owner a proprietary interest in this valuable information device even if no substantial consumer association has oc-

8. *Id.* § 1052.
9. *Id.* § 1072.
10. GOLDSTEIN, *supra* note 3, at 296.
11. *Id.*
12. 15 U.S.C. § 1064 (1988).
13. *Id.* § 1065.
14. *Id.* § 1115.
15. *Id.* § 1116.
16. *Id.* § 1117.
17. *Id.* § 1118.
18. GOLDSTEIN, *supra* note 3, at 203, 223.
19. Abercrombie & Fitch Co. v. Hunting World, Inc., 537 F.2d 4, 9 (2d Cir. 1976).
20. GOLDSTEIN, *supra* note 3, at 223.
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*

curred.[25] Section 43(a) of the Lanham Act provides statutory protection for trade dress infringement claims.[26] Courts define trade dress as the total image of a product and include features such as size, shape, color, color combinations, texture and graphics.[27] Examples include the well-known configuration of a whiskey pinch bottle[28] or the distinct look of a greeting card.[29] The statute provides recovery for a party injured by a competitor's "false designation of origin, false or misleading description of fact, or false or misleading representation of fact" in regard to its product.[30] Section 43(a) does not contain registration instructions unlike the section pertaining to trademarks. Claims typically arise out of misleading packaging or trade dress.[31] Generally, the plaintiff must establish: (1) nonfunctionality; (2) a likelihood of consumer confusion; and (3) secondary meaning.[32] The Supreme Court requires a showing of secondary meaning only if the trade dress is not inherently distinctive[33]—thereby paralleling the trade dress test with trademark law even though Section 43(a) does not contain a distinctiveness requirement.

1. The Trade Dress Test

Courts first determine if trade dress is functional or nonfunctional in nature. Trade dress protects nonfunctional or ornamental configurations of a product's package, but not functional or utilitarian features.[34] Nonfunctional features include, for example, a style of a greeting card,[35] a fishing reel cover,[36] the visual impression of a restaurant[37] and a pinch whiskey bottle.[38] The determination of functional features has proved difficult for courts to make in a uniform fashion.[39] The Second

25. Two Pesos, Inc. v. Taco Cabana, Inc., 112 S. Ct. 2753, 2761 (1992).

26. GOLDSTEIN, *supra* note 3, at 354.

27. AmBrit, Inc. v. Kraft, Inc., 812 F.2d 1531, 1535 (11th Cir. 1986), *cert. denied*, 481 U.S. 1041 (1987).

28. *Ex parte* Haig & Haig Ltd., 118 U.S.P.Q. (BNA) 229, 230 (1958).

29. Hartford House Ltd. v. Hallmark Cards, Inc., 846 F.2d 1268 (10th Cir.), *cert. denied*, 488 U.S. 908 (1988).

30. The section provides:

> (a) Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact . . . shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

15 U.S.C. § 1125 (1988).

31. Dawn R. Duven, Comment, *The Present Scope of Recovery for Unfair Competition Violations Under Section 43(a) of the Lanham Act*, 58 NEB. L. REV. 159, 165 (1978).

32. *Hartford House*, 846 F.2d at 1271.

33. Two Pesos, Inc. v. Taco Cabana, Inc., 112 S. Ct. 2753 (1992).

34. Culley & Williams, *supra* note 2, at 181. *But see* Jessica Litman, Note, *The Problem of Functional Features: Trade Dress Infringement Under Section 43(a) of the Lanham Act*, 82 COLUM. L. REV. 77, 80 (1982) (discussing how the functionality doctrine was improperly imported from the common law doctrine of unfair competition and should not be used in deciding trade dress infringement).

35. *Hartford House*, 846 F.2d at 1268.

36. Brunswick Corp. v. Spinit Reel Co., 832 F.2d 513 (10th Cir. 1987).

37. Fuddruckers, Inc. v. Doc's B.R. Others, Inc., 826 F.2d 837 (9th Cir. 1987).

38. *Ex parte* Haig & Haig Ltd., 118 U.S.P.Q. (BNA) 229 (1958).

39. Culley & Williams, *supra* note 2, at 181.

Circuit claims a functional feature must be essential to the use or purpose of the article, or affect the cost or quality.[40] The Fifth Circuit defines functionality as a feature of an article superior or optimal in terms of engineering, economy of manufacture or accommodation of utilitarian function or performance;[41] the Seventh Circuit defines functionality as a feature shared by different brands that is costly not to have;[42] and the Tenth Circuit defines it as the feature creating a monopoly which would prevent others from successfully competing.[43]

Next, a plaintiff must show "likelihood of consumer confusion," the main purpose of the Lanham Act.[44] In determining consumer confusion, the Tenth Circuit adopted the factors listed in the Restatement of Torts.[45] These factors include: (1) the degree of similarity between designation and the trade dress; (2) appearance; (3) suggestions; (4) intent of the party in adopting the designation; and (5) the relation in use and manner of marketing between goods marketed by the party and those marketed by another.[46] The plaintiff does not need to show actual consumer confusion but it may be the strongest evidence to support such a determination.[47]

Finally, trade dress traditionally required a demonstration of secondary meaning. A label or package has secondary meaning when a consumer associates it with a certain producer and will make the same association when another uses a similar label or package design.[48] The public need not know the identity of the manufacturer, only that the product comes from a single but anonymous source.[49]

A plaintiff proves secondary meaning with either direct or circumstantial evidence. One commentator has stated that "[d]irect evidence consists of the testimony of consumers as to their states of mind at the time they purchased the product."[50] A plaintiff establishes circumstantial evidence by demonstrating the seller's efforts in advertising the product to a wide group of potential purchasers.[51] In *Two Pesos, Inc. v. Taco Cabana, Inc.*, the Supreme Court eliminated the need to demon-

40. Beth F. Dumas, *The Functionality Doctrine in Trade Dress and Copyright Infringement Actions: A Call for Clarification*, 12 HASTINGS COMM. & ENT. L.J. 471, 480 (1990).

41. Sicilia Di R. Biebow & Co. v. Cox, 732 F.2d 417, 429 (5th Cir. 1984).

42. Service Ideas, Inc. v. Traex Corp., 846 F.2d 1118, 1123 (7th Cir. 1988).

43. Hartford House, Ltd v. Hallmark Cards, Inc., 846 F.2d 1268, 1273 (10th Cir.), *cert. denied*, 488 U.S. 908 (1988); Brunswick Corp. v. Spinit Reel Co., 832 F.2d 513, 519 (10th Cir. 1987).

44. 15 U.S.C. § 1127 (1988). *See* Michael J. Allen, *The Scope of Confusion Actionable Under Federal Trademark Law: Who Must Be Confused and When?*, 26 WAKE FOREST L. REV. 321 (1991).

45. Beer Nuts, Inc. v. Clover Club Foods Co., 805 F.2d 920, 925 (10th Cir. 1986); *See* RESTATEMENT OF TORTS § 729 (1938).

46. *Beer Nuts*, 805 F.2d at 925. These factors are not comprehensive.

47. *Brunswick*, 832 F.2d at 521.

48. Litman, *supra* note 34, at 80.

49. Culley & Williams, *supra* note 2, at 184.

50. Timothy R.M. Bryant, Comment, *Trademark Infringement: The Irrelevance of Evidence of Copying to Secondary Meaning*, 83 Nw. U. L. Rev. 473, 485 (1989).

51. *Id.* at 486.

strate secondary meaning for inherently distinctive trade dress.[52]

2. Conflict Among the Circuits as to Secondary Meaning

Until 1992, a conflict existed between the circuits as to whether trade dress infringement required actual proof of secondary meaning. The Second Circuit, most notably, demanded evidence of secondary meaning before granting trade dress protection.[53] In *Vibrant Sales, Inc. v. New Body Boutique, Inc.*,[54] the Second Circuit relied on a presumption that registered marks indicate the source of the product whereas unregistered marks do not, absent a showing of secondary meaning.[55] The Fifth Circuit, however, followed Judge Friendly's test from *Abercrombie*,[56] and did not require a showing of secondary meaning when the trade dress was inherently distinctive.[57] The Eleventh[58] Circuit also agreed with Judge Friendly's approach.

Until *Two Pesos, Inc. v. Taco Cabana, Inc.*,[59] the circuits received little guidance from the Supreme Court. Only two Supreme Court cases had even mentioned the concept of trade dress and neither contained much discussion on the matter. The Court hinted at the possibility of recovery for infringement of trade dress in *Inwood Lab., Inc. v. Ives Lab., Inc.*[60] and *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*[61] In *Inwood Lab.*, the Court only acknowledged that trade dress protection may exist and remanded to the court of appeals to determine the infringement claim.[62] The Court recognized trade dress protection in *Bonito Boats*, but in a design patent context.[63] The Court ignored an early chance to establish a uniform trade dress test among the federal circuits.

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52. 112 S. Ct. 2753 (1992).

53. Industria Arredamenti Fratelli Saporiti v. Charles Craig, Ltd. 725 F.2d 18, 19 (2d Cir. 1984); *see also* American Greetings Corp. v. Dan-Dee Imports, Inc., 807 F.2d 1136, 1141 (3d Cir. 1986); Prufrock Ltd., Inc. v. Lasater, 781 F.2d 129, 132 (8th Cir. 1986); Kwik-Site Corp. v. Clear View Mfg. Co., Inc., 758 F.2d 167, 178 (6th Cir. 1985); Keebler Co. v. Rovira Biscuit Corp., 624 F.2d 366, 378 (1st Cir. 1980).

54. 652 F.2d 299 (2d Cir. 1981), *cert. denied*, 455 U.S. 909 (1982).

55. *Id.* at 304. After its decision in *Vibrant*, the Second Circuit announced it would follow the classification of marks set out by Judge Friendly in Abercrombie & Fitch Co. v. Hunting World, Inc., 537 F.2d 4, 7 (2d Cir. 1976); Thompson Medical Co. v. Pfizer, Inc., 753 F.2d 208 (2d Cir. 1985). Regardless of this decision, the court still continued to deny trade dress protection absent proof of secondary meaning. *See* LeSportsac, Inc. v. K Mart Corp., 754 F.2d 71, 75 (2d Cir. 1985).

56. 537 F.2d 4, 9 (2d Cir. 1976).

57. Chevron Chemical Co. v. Voluntary Purchasing Groups, Inc., 659 F.2d 695, 702-03 (5th Cir. 1981), *cert. denied*, 457 U.S. 1126 (1982).

58. AmBrit, Inc. v. Kraft, Inc., 805 F.2d 974, 979 (11th Cir. 1986), *cert. denied*, 481 U.S. 1041 (1987).

59. 112 S. Ct. 2753 (1992).

60. 456 U.S. 844 (1982).

61. 489 U.S. 141 (1989).

62. 456 U.S. at 858-59.

63. 489 U.S. at 154.

3. *Two Pesos, Inc. v. Taco Cabana, Inc.*[64]

a. *Facts*

Taco Cabana, Inc. operated a chain of fast food restaurants in Texas.[65] The restaurant first opened in San Antonio in September of 1978, expanding to five additional San Antonio sites in 1985 and the Houston and Austin markets by 1986.[66] Taco Cabana described its Mexican trade dress as a festive atmosphere having interior dining and patio areas decorated with bright neon colors, paintings, murals, and artifacts. The stepped exterior of the building had a vivid color scheme using top border paints and neon stripes. Bright awnings and umbrellas continued the theme.[67] In December, 1985, Two Pesos opened a restaurant in Houston with a very similar Mexican motif.[68] Taco Cabana sued Two Pesos for trade dress infringement under section 43(a) of the Lanham Act.[69]

The trial court instructed the jury that Taco Cabana's trade dress was protected if either it was inherently distinctive or had acquired secondary meaning.[70] The jury found that: (1) Taco Cabana had an inherently distinctive trade dress; (2) the trade dress had not acquired secondary meaning in the Texas market; and (3) the alleged infringement created a likelihood of confusion on the part of the ordinary customer.[71] In the course of calculating damages, the trial court held that Two Pesos intentionally and deliberately infringed on Taco Cabana's trade dress.[72]

The Fifth Circuit ruled that the instructions adequately stated the applicable law and that the evidence supported the jury's findings. The court rejected Two Pesos' argument that a finding of no secondary meaning contradicted a finding of inherent distinctiveness.[73]

b. *Supreme Court's Majority Opinion*

Justice White, writing for the majority, affirmed the Fifth Circuit opinion by drawing parallels from the well-established trademark field.[74] The decision analyzed the trade dress issue specifically relying on the categorization of trademarks described by Judge Friendly.[75] The Court found no persuasive reason why the analysis of trademark and trade dress should differ.[76]

64. 112 S. Ct. 2753 (1992).
65. *Id.* at 2755.
66. *Id.* at 2755-56.
67. *Id.* at 2755
68. *Id.*
69. *Id.* at 2756 (citing 15 U.S.C. § 1125 (1982)).
70. *Id.*
71. *Id.*
72. *Id.*
73. Taco Cabana Int'l, Inc. v. Two Pesos, Inc., 932 F.2d 1113, 1120 (5th Cir. 1991).
74. *Two Pesos*, 112 S. Ct. at 2760.
75. *Id.* at 2757.
76. *Id.* at 2760.

The Court rejected Two Pesos's argument that trade dress should have only temporary protection and be subject to defeasance if failing to acquire secondary meaning.[77] The Court stated that if a mark is inherently distinctive, the failure of it obtaining secondary meaning does not remove this distinctiveness. Instead, the fact that the public does not associate a product with a source indicates the failure of a business to be successful in the marketplace.[78]

The majority analyzed the conflict in the federal courts of appeal and concluded that the Fifth Circuit's test that did not require secondary meaning for inherently distinctive marks furthered the purposes of the Lanham Act, i.e., preventing deception and unfair competition.[79] The Court found that adding a secondary meaning requirement could have anticompetitive effects, which might create particular burdens on the start-up of small companies.[80]

c. *Concurring Opinions*[81]

Justice Thomas relied not on adjacent sections of the Lanham Act but solely on the language of section 43(a) before amended.[82] At common law arbitrary, fanciful and suggestive marks were presumed to represent the source of a product. The first user could sue a second without having to demonstrate that the mark in fact represented the product's source.[83]

Trade dress at common law seemed incapable of being inherently distinctive making secondary meaning a requirement for protection.[84] Over time judges learned that packaging can be as arbitrary or fanciful as a word or symbol. Courts recognized that trade dress could serve as a representation or designation of source under section 43(a).[85] Therefore, secondary meaning was no longer necessary.[86]

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77. *Id.* at 2759.

78. *Id.*

79. *Id.* at 2760.

80. *Id.* at 2761.

81. Justice Stevens concentrated on the transformation of meaning that Section 43(a) has experienced in the past decades. *Id.* at 2761 (Stevens, J., concurring). In the past, false designation of origin meant exclusively a misrepresentation of geographic origin. False description or representation encompassed two kinds of wrongs, false advertising and passing off. The passing off claim contained an element of secondary meaning. *Id.* at 2762.

Justice Stevens discussed how the courts of appeal have expanded the categories to include misrepresentation of the origin of manufacture. *Id.* at 2762-63. The expansion was unsupported by the Act's language, but Justice Stevens believed it furthered the Act's general purposes. *Id.* at 2764. Congress had accepted the expansion by broadening § 43(a) to include a likelihood of consumer confusion test. *Id.* Justice Stevens concurred with the majority decision because stare decisis persuaded him that secondary meaning need not be shown. *Id.* at 2765-66.

82. *Id.* at 2766-67 (Thomas, J., concurring).

83. *Id.*

84. *Id.*

85. *Id.* at 2767.

86. *Id.* at 2761 (Scalia, J., concurring) (Justice Scalia wrote a separate note to voice his complete agreement with Justice Thomas's explanation as to how the language of 43(a)

B. *Analysis*

1. Prior Tenth Circuit Tests

The Tenth Circuit has decided few cases in the area of trade dress since its first trade dress decision in 1985.[87] The court held that alphanumeric markings on the top of a wellhead were descriptive and, therefore, not entitled to trade dress protection.[88] The opinion suggested, but did not decide, that secondary meaning would not be necessary for inherently distinctive trade dress.[89] The Tenth Circuit's next opinion contained a footnote stating that secondary meaning might not be necessary for inherently distinctive dress, but expressly declined to decide the matter.[90]

The most recent Tenth Circuit case, *Hartford House, Ltd. v. Hallmark Cards, Inc.*,[91] articulated a trade dress test that required the plaintiff to establish an acquired secondary meaning for trade dress protection.[92] The issue that was appealed did not involve secondary meaning; however, the court did not as before include a caveat footnote stating that the issue of secondary meaning was undecided.[93] Any uncertainty in the Tenth Circuit's use of secondary meaning for distinctive dress vanished with the *Two Pesos* decision.

2. Impact of Two Pesos

*Two Pesos* brought not only uniformity to this area, but also some confusion. The Supreme Court did not clarify whether the removal of the secondary meaning requirement brought trade dress squarely within the established law of trademarks, or if it will continue as a separate concept. The Court did not state whether trade dress could now be registered if a court finds the trade dress inherently distinctive. Additionally, the Court did not indicate whether secondary meaning had applicability in other prongs of the test, such as likelihood of confusion.

The majority opinion relied on the *entire* Lanham Act to delete the need for secondary meaning with inherently distinctive trade dress. In doing so, the Court ignored the structure and organization of the statute. Section 43(a) embodies an alternative for protection of unregistered marks, words, and symbols.[94] The Court compared Section 43(a) with Sections 1 and 2 of the Lanham Act which specifically apply to registered marks. The Court did not clarify if the test that allows for protection of trade dress also determines if the dress becomes a registered mark. Instead of reverting to well-established trademark law, the

and its common-law derivation are broad enough to embrace inherently distinctive trade dress.).

87. J.M. Huber Corp. v. Lowery Wellheads, Inc., 778 F.2d 1467 (10th Cir. 1985).
88. *Id.*
89. *Id.* at 1470.
90. Brunswick Corp. v. Spinit Reel Co., 832 F.2d 513, 517 n.2 (10th Cir. 1987).
91. 846 F.2d 1268 (10th Cir. 1988).
92. *Id.* at 1271.
93. *Id.*
94. Duven, *supra* note 31, at 159.

Supreme Court should have distinguished trademark law from trade dress law. Trade dress, unlike trademarks, encompasses the entire look of a product requiring consideration of more factors than does trademark law. By paralleling the sections, the Court implied that trade dress may be entitled to registration.

The term "secondary meaning" does not exist in the text of the statute relating to registered or non-registered marks. Section 2 articulates an exception for marks used by the applicant which have become distinctive of the applicant's goods in commerce.[95] Courts created secondary meaning as a way to differentiate between descriptive marks and arbitrary or fanciful marks.[96] The purpose of Section 2 is to distinguish between the marks the Trademark Office registers and does not register. In this decision, the Court implied Section 2 applies to trade dress protection. Thus, trade dress appears to be registerable whether or not the Court intended that result.[97]

The Court did not discuss the likelihood of confusion prong of the test as it was not appealled.[98] Through the Lanham Act Congress codified the common law provisions of trademark and unfair competition.[99] Congress articulated that the purpose for the law was to prevent the likelihood of confusion and consumer deception. This language appears in both Section 1 and Section 43(a).[100] Secondary meaning may be helpful in determining the third prong of proving likelihood to confuse consumers, the heart of the Lanham Act. Secondary meaning exists when a consumer associates a name, symbol or package appearance with a particular source.[101] Confusion occurs when another manufacturer replicates that image. Without an association between a product and its producer, the consumer cannot be confused as to the source of the product. Proving the existence of an association establishes a prima facie case of a likelihood of confusion. An inherently distinctive product does not necessarily have the association to a particular source. Courts recognize that the factors used to determine likelihood of confusion are not exclusive.[102] Secondary meaning is a potentially probative way to determine likelihood of confusion. Although the Court removed the necessity of showing secondary meaning for the second prong of the trade dress test, that does not preclude using secondary meaning for determining the third prong—likelihood of consumer confusion.

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95. 15 U.S.C. § 1052(f) (1988).

96. *See* Charcoal Steak House of Charlotte, Inc. v. Staley, 139 S.E.2d 185 (N.C. 1964).

97. Some types of containers and packaging have acquired registered status. *See Ex parte* Haig & Haig Ltd., 118 U.S.P.Q. (BNA) 229 (1958). However, the concept of trade dress encompasses a more intangible idea of overall visual effect as well as the products packaging. Julius Lunsford, *The Protection of Packages and Containers*, 56 TRADEMARK REP. 567 (1966) (discussing whether overall image is afforded registration).

98. *Two Pesos*, 112 S. Ct. at 2758.

99. *See* GOLDSTEIN, *supra* note 3, at 55-56.

100. 15 U.S.C. §§ 1051, 1152 (1988).

101. Litman, *supra* note 34, at 79.

102. Beer Nuts, Inc. v. Clover Club Foods Co., 805 F.2d 920 (10th Cir. 1986); *see* RESTATEMENT OF TORTS § 729 (1938).

Justice Thomas correctly noted that the Court relied on common ground between the sections of the Act without stating a reason for such a holding. Such an approach seems more in tune with the meaning of the Lanham Act. By focusing on common law reasons for Section 43(a), he did not parallel trade dress with trademarks. This analysis precludes a possibility of registration for trade dress.

### C. *Conclusion*

The Court opened a new door for plaintiffs looking for trade dress protection. Under this decision, registration of trade dress is possible. The complexity likely to result from trying to register all the factors of trade dress, however, makes the proposition unworkable. By pulling the unfair competition claim of trade dress into the arena of trademarks, the Court made trade dress identical to trademarks, when in reality, differences exist. Discord still exists among the circuits as to how a plaintiff proves functionality[103] and likelihood of confusion.[104] The Court decided only one aspect of the trade dress infringement claim, leaving the more controversial prongs of functionality and consumer confusion undecided.

## III. Expansion of the Duty of Candor in a Patent Reexamination Proceeding

No major substantive changes have occurred in patent law since the 1966 Supreme Court decision in *Graham v. John Deere Co.*[105] where the Court added a new prong to the patentability test. The procedures available to challenge patent validity, however, have changed. A patent challenger can now request a patent reexamination.[106] Implicit in any patent proceeding is the element of candor and good faith. The Tenth Circuit, in *Ball Corp. v. Xidex Corp.*,[107] broadened the duty of good faith to the reexamination requester rather than traditionally limiting it to the patent defender.[108] The court, however, did not establish procedures to make that extension meaningful, such as expanding the requester's participation.

### A. *Background*

After the Patent and Trademark Office (PTO) issues a patent to a successful applicant, the patent can be altered in only two ways. First, if the PTO discovers a patent is wholly or partially inoperative through error without any deception, the Commissioner may reissue the patent in accordance with the amended application.[109] Second, now Chapter

103. Dumas, *supra* note 40, at 471.
104. Allen, *supra* note 44, at 321-22.
105. 383 U.S. 1 (1966).
106. 35 U.S.C. § 302 (1988).
107. 967 F.2d 1440 (10th Cir. 1992).
108. *Id.*
109. 35 U.S.C. § 251 (1988).

30 of the Patent Act allows any person to file a reexamination request at any time to challenge the validity of the patent.[110]

Patent reexamination procedures[111] provide an additional forum besides federal district court to determine the validity of patents.[112] Several problems exist for a patent attorney practicing in federal court. Litigation is extremely expensive in a patent case due to the traditional use of several experts,[113] and the judge and jury in federal court usually lack the expertise in the pertinent technology.[114] A reexamination proceeding, however, utilizes the technical expertise of PTO examiners, does not allow discovery or witnesses, and is less expensive than litigation.[115]

The procedure for reexamination begins with a request by any person, including the patent owner, to the PTO and payment of a $2,000 fee.[116] The scope of the reexamination focuses primarily on issues based upon previous patents or printed publications describing prior art.[117] It excludes other important issues of patentability such as patent misuse, inequitable conduct making a patent unenforceable, inadequacy of disclosure and fraud on the PTO.[118] A federal court must decide if these defects exist.

After receipt of the request, the Commissioner determines whether a substantial new question of patentability exists.[119] If the Commissioner decides that the evidence does not raise a question of patentability, the decision is final and not appealable.[120] If the Commissioner agrees with the patent challenger that an issue of patentability exists, a reexamination is ordered.[121] The patent owner then has two months to file a statement regarding the issues raised in the request for reexamination.[122] The reexamination requester has an opportunity to file a reply to the owner's statement.[123] However, if the owner does not file a response, the requester may not file a reply and the requester's participation in the reexamination is ended.[124] The only way for a challenger to

110. *Id.* § 302.

111. Pub. L. No. 96-517 § 1, 94 Stat. 3015 (1980) (codified at 35 U.S.C. § 251 (1988)).

112. George N. Neff, *Patent Reexamination—Valuable, But Flawed: Recommendations for Change*, 68 J. PAT. & TRADEMARK OFF. SOC'Y 575 (1986).

113. *Id.*

114. *Id.* This has somewhat been removed with the creation of the Court of Appeals for the Federal Circuit (CAFC). The Federal Court Improvement Act of 1982 withdrew patent jurisdiction from the twelve regional courts of appeals and granted exclusive jurisdiction to the CAFC. Pub. L. No. 97-164, 96 Stat. 25 (codified at 28 U.S.C. § 1295 (1988)).

115. Neff, *supra* note 112, at 576.

116. 35 U.S.C. § 302 (1988); MANUAL OF PATENT EXAMINING PROCEDURE § 2215 (5th ed. 1983) [hereinafter MPEP].

117. 35 U.S.C. § 301 (1988).

118. Neff, *supra* note 112, at 576-77.

119. 35 U.S.C. § 303 (1988).

120. *Id.* Upon this finding a refund of $1,500 is given to the patent reexamination requester. MPEP, *supra* note 116, § 2215.

121. 35 U.S.C. § 304 (1988).

122. *Id.*

123. *Id.*

124. Neff, *supra* note 112, at 578.

make additional arguments is to file another reexamination request after paying another $2,000.[125]

Patents extend a valuable monopoly to the patent owner. Privileged monopolies constitute an anomaly in our economy founded on the concept of free enterprise.[126] Due to this advantage, public interest demands that patent monopolies not be granted through fraudulent or inequitable conduct.[127] Those with applications pending with the PTO have an uncompromising duty to report all facts concerning possible fraud or inequity.[128] The purpose for this uncompromising duty is due to the ex parte nature of a patent application or reexamination proceeding.[129] Courts do not view this as a true adversarial proceeding.[130] The PTO does not have full research facilities nor were such facilities intended by Congress.[131] In examining applications, the PTO relies heavily upon the prior art references cited in the application.[132]

Section 1.555 of the Code of Federal Regulations specifically calls for a duty of candor and good faith for individuals brought before the PTO for a reexamination hearing.[133] The language of the regulation states that the duty of disclosure applies to "the patent owner, each attorney or agent who represents the patent owner, and every other individual who is substantially involved on behalf of the patent owner."[134] The regulation does not mention a duty of candor for the reexamination requester, only the defender.

To find that someone has breached the duty of candor, the court looks for three elements. First, the breacher must have intended the breaching act through deliberate concealment, falsehoods in petitions, misrepresentations, or false affidavits.[135] Some courts have relaxed the requirement of intent, holding unintentional misrepresentation as ade-

125. *Id.*

126. S. William Cochran, *Historical Review of Fraud in Patent Procurement: The Standards and Procedures for Doing Business Before the Patent Office*, 52 J. PAT. OFF. SOC'Y 71 (1970).

127. *Id.*

128. Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co., 324 U.S. 806, 818 (1945).

129. Michael J. Ram, *Patent Fraud: A New Defense?*, 54 J. PAT. OFF. SOC'Y 363, 373 (1972).

130. *See* Carter-Wallace, Inc. v. Davis-Edwards Parmacal Corp., 443 F.2d 867 (2d Cir. 1971). Judge Mansfield disagreed with this proposition. He stated that in patent application prosecutions, unlike most ex parte proceedings, the examiners act like adversaries representing the general public. *Id.* at 885 (Mansfield, J., dissenting).

131. *See* Beckman Instruments, Inc. v. Chemtronics, Inc., 428 F.2d 555, 564 (5th Cir. 1970).

132. *Id.* The Patent Examiner is not limited to the references cited by the patent applicant and is obligated to fully search the references in the field. Ram, *supra* note 129, at 374 (quoting L. AMDUR, PATENT OFFICE RULES AND PRACTICE 104 (1959)).

133. 37 C.F.R. § 1.555 (1991). The PTO has recently revised the regulation to parallel the duty of disclosure in patent application proceedings. Duty of Disclosure, 57 Fed. Reg. 2021-36 (1992) (to be codified at 37 C.F.R. § 1.555). The type of information required to be disclosed at a patent reexamination has changed, but the regulation still does not define who must disclose this information. *Id.* The patent requester again is noticeably left out of the statutory change.

134. *Id.* at 2036.

135. Ram, *supra* note 129, at 371.

quate evidence of lack of candor.[136] Second, the fraudulent misrepresentations must be material in granting the patent.[137] This is determined objectively by the court or PTO.[138] Courts consider both intent and materiality together to determine inequitable conduct.[139] A higher level of materiality requires a lower level of intent.[140] Finally, the examiner must have relied on the misrepresentations.[141]

The courts have lacked consistentcy in determining whether a breach of the duty of candor exists. In *Beckman Instruments, Inc. v. Chemtronics, Inc.*,[142] the Fifth Circuit concentrated on the intent of the parties. Due to intentional concealment by the patent owner, the court invalidated the patent.[143] The Federal District Court for the Northern District of California found a breach of the duty of candor upon a showing of gross negligence.[144] Moreover, the consequences of inequitable conduct by a reexamination requester have not been defined in any case. The Commissioner of Patents and Trademarks has suggested inequitable conduct by the requester would not vacate the reexamination proceeding.[145] The Commissioner stated a patent owner has an opportunity to correct any misstatements of facts.[146] The Tenth Circuit did not define requisite level of intent and expanded the duty of candor to patent requesters without discussing the consequences of a breach.[147]

## B. Ball Corp. v. Xidex Corp.[148]

### 1. Facts

Ball Corporation (Ball) holds the Roller patent[149] for a method of

136. *Id.* at 372. The District Court of Northern California stated that "a finding of gross negligence will warrant a holding of inequitable conduct if the undisclosed or misstated information meets the objective 'but for' test of materiality." Micro Motion, Inc. v. Exac Corp., 686 F. Supp. 789, 796 (N.D. Cal. 1987).

137. Ram, *supra* note 129, at 372.

138. *See generally* Allen Archery, Inc. v. Browning Mfg. Co., 819 F.2d 1087 (Fed. Cir. 1987); Akzo N.V. v. United States Int'l Trade Comm'n, 808 F.2d 1471 (Fed. Cir. 1986), *cert. denied* 482 U.S. 909 (1987); Hycor Corp. v. Schlueter Co., 740 F.2d 1529 (Fed. Cir. 1984).

139. *Akzo N.V.*, 808 F.2d at 1481.

140. *Id.* at 1481-82. Courts generally recognize four levels of materiality: (1) there is a substantial likelihood that a reasonable examiner would consider it important in deciding patentability; (2) the information might reasonably affect the examiner's decision to issue a patent; (3) the examiner would have rejected the claims even though the claims were patentable; and (4) the information in fact renders the claims unpatentable. Micro Motion, Inc. v. Exac Corp., 686 F. Supp. 789, 796 (N.D. Cal. 1987).

141. *Akzo N.V.*, 808 F.2d at 1481.

142. 428 F.2d 555 (5th Cir. 1970).

143. *Id.* at 566.

144. *Micro Motion*, 686 F. Supp. at 789.

145. *In re* Burkner, 3 U.S.P.Q.2d (BNA) 1630, 1633 (1987).

146. *Id.*

147. Ball Corp. v. Xidex Corp., 967 F.2d 1440 (10th Cir. 1992)[hereinafter *Ball II*] (references to Ball Corp. v. Xidex Corp., 705 F. Supp. 1470 (D. Colo. 1988) are hereinafter *Ball I*).

148. *Id.*

149. United States Patent No. 3,778,308 was issued to inventors Kent G. Roller, George H. Alhorn and Richard E. Brown in December of 1973. *Id.*

lubricating magnetic storage devices such as computer memory disks, drums and tapes. The Roller patent describes "the application of a lubricant known as perfluoralkyl polyether (PFA) over a substrate of magnetic material."[150] Xidex Corporation (Xidex) "has used PFA as a lubricant since 1978 without a license from Ball."[151] Xidex disputed whether the Roller patent covered use of PFA by Xidex. Xidex argued that the thickness of the PFA coating was the material element of the process and that the Roller patent only covered products falling within the thickness range described in the patent.[152] Ball broadly defined its patent as simply PFA applied to storage devices in a thin coating regardless of a specific thickness.[153]

In 1986, Ball filed a patent infringement suit before the Colorado Federal District Court against Xidex claiming the Xidex disks fell within the thickness specifications.[154] Xidex asked the trial court to declare certain materials confidential for purposes of the patent infringement claim and to keep certain sales reports under the court's protective order.[155] After substantial discovery in the patent infringement case, Xidex instituted a reexamination proceeding in the PTO claiming the Roller patent was obvious in light of prior art.[156] The patent examiner agreed with Xidex and invalidated certain claims of the patent.[157] Ball brought a subsequent suit claiming Xidex damaged the company by making false statements and withholding material evidence during the reexamination proceeding.[158] Ball also argued that Xidex, the reexamination requester, breached its duty of candor and good faith to the PTO. Ball stated the standard of intent was only gross negligence.[159]

The trial court found that Mr. Kujawa, Xidex' attorney, did not act maliciously and had a reasonable belief regarding the materiality of the thickness specifications.[160] Mr. Kujawa's actions did not rise to the level of negligence. Since Ball failed to prove the causation element of the claimed torts, the court dismissed all of Ball's claims.[161]

2. The Tenth Circuit Decision

The Tenth Circuit expanded the responsibilities of a patent reexamination requester without determining what level of intent constitutes a breach. The court stated that the uncompromising duty of candor described in section 1.555 requires a patent owner, attorney or agent of

150. *Id.* at 1442.
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.*
156. *Id.*
157. *Id.*
158. *Ball I*, 705 F. Supp. 1470, 1471 (D. Colo. 1988).
159. *Ball II*, 967 F.2d at 1445.
160. *Id.* at 1443. The trial court also determined Xidex was entitled to a qualified immunity under the First Amendment for defamatory statements made before the PTO. *Ball I*, 705 F. Supp. at 1472.
161. *Ball II*, 967 F.2d at 1443.

the patent owner to bring materials to the attention of the PTO as they become aware of the information.[162] The court extended the duty of candor to the reexamination requester as well as the patent defender even though the statutory language mentions only the patent defender.[163] Implicit with that duty was an element of intent.[164] Mr. Kujawa had a duty to disclose all evidence material to the determination of patentability and a duty to correct misrepresentations.[165] In this case, however, Mr. Kujawa lacked the requisite intent to have breached his duty to the PTO.[166] The court did not decide what level of intent was necessary, and simply accepted the trial court's finding that Mr. Kujawa did not act even negligently.[167]

C. *Analysis*

The Tenth Circuit Court of Appeals extended the responsibility of candor and good faith to the patent reexamination requester. It did not reach this decision by examining the regulatory language of section 1.555 which applies only to the patent owner, representatives of the owner and anyone substantially involved on behalf of the patent owner.[168] This extension, however, seems logical. The Supreme Court imposes a duty of disclosure and candor on all parties involved with the PTO.[169] An increase in moral responsibility generally benefits all legal proceedings. However, commentators have suggested more attention should be focused on technical and economic facts rather than on moral questions.[170]

The court did not elaborate on what this duty entails. Although recognizing that the level of intent was the heart of the issue,[171] the Tenth Circuit failed to reach a conclusion on this important question. Ball argued that the level of intent should be gross negligence, or at most recklessness.[172] The court stated that since Mr. Kujawa had a reasonable belief in his statements his conduct did not even rise to the level of negligence.[173] By leaving this question unanswered, the court did

162. *Id.* at 1447; *see* 37 C.F.R. § 1.555 (1992).
163. *Ball II*, 967 F.2d at 1447.
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.* at 1446 n.6. The court also held that the district court erred in holding that Xidex' statements were protected by a qualified immunity. *Id.* at 1445. Relying on Supreme Court precedent, the Tenth Circuit found an absolute immunity for attorneys against defamation claims. *Id.* at 1445 (citing Robinson v. Volkswagenwerk AG, 940 F.2d 1369 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 1160 (1992)). This immunity, however, does not extend to allegations of fraud. *Id.* at 1444.
168. 37 C.F.R. § 1.555 (1992).
169. Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co., 324 U.S. 806, 818 (1945).
170. Donald S. Chisum, *Patent Law and the Presumption of Moral Regularity: A Critical Review of Recent Federal Circuit Decisions on Inequitable Conduct and Willful Infringement*, 69 J. PAT. & TRADEMARK OFF. SOC'Y 27, 28 (1987).
171. *Ball II*, 967 F.2d at 1445.
172. *Id.*
173. *Id.*

not decide whether traditional liability principles are applicable to PTO proceedings.

The Supreme Court described this duty of candor as uncompromising.[174] The Tenth Circuit stated that the duty applies whenever a participant is or becomes aware of any information material to the PTO's determination of patent validity. Extending this duty to the reexamination requester places an even higher burden on that individual due to the ex parte nature of the proceedings. Commentators, however, call the lack of participation by the requester one of the biggest flaws in the new procedure.[175] An uncompromising duty of candor falls particularly heavily on a requester. The only opportunity a requester has to address the PTO occurs in the initial request, and possibly in a reply, provided the patent owner files a response. Presently, no procedures exist to amend or add to a reexamination request. *Ball* indicates a movement towards a more interactive role for the requester.

The duty may have little practical effect. *In re Burkner*[176] suggests the inequitable conduct on the part of a requester has no effect on the proceeding. The Commissioner would not vacate the reexamination even after a showing of inequitable conduct, because the patent owner can correct any misrepresentations during the reexaminaiton proceeding. The Tenth Circuit, however, by extending this duty, probably did not intend it to be only cosmetic or superficial. By not enumerating procedures to enforce the duty, it might not be effectively upheld.

The Tenth Circuit only mentioned the test of materiality in determining whether Mr. Kujawa breached the duty of candor. The opinion stated: "Mr. Kujawa lacked awareness of the information's materiality, and he therefore did not have the requisite intent to breach his duty to the PTO."[177] It appears that the Tenth Circuit used a subjective test for materiality. This is not sound. Prior case law indicates that the PTO must determine what is material and what is not.[178] The Federal District Court for the Northern District of California, in *Micro Motion, Inc. v. Exac Corp.*,[179] stated that materiality and intent are intertwined when determining inequitable conduct. The court did not propose that materiality should be measured by an indiviidual's own subjective view.[180] If courts use a subjective view, a problem with bias arises. The PTO or courts must decide the objective level of materiality before applying it to the issue of intent. Although simple negligence and erroneous judgment are insufficient to constitute a breach even when the information is extremely material, the standard still must remain objective.[181] Here,

174. *Precision Instrument*, 324 U.S. at 818.
175. Neff, *supra* note 112, at 575.
176. 3 U.S.P.Q.2d (BNA) 1630 (1987).
177. *Ball II*, 967 F.2d at 1447.
178. *See* Allen Archery, Inc. v. Browning Mfg. Co., 819 F.2d 1087 (Fed. Cir. 1987); Akzo N.V. v. United States Int'l Trade Comm'n, 808 F.2d 1471 (Fed. Cir. 1986), *cert. denied*, 482 U.S. 909 (1987); Hycor Corp. v. Schlueter Co., 740 F.2d 1529 (Fed. Cir. 1984).
179. 686 F. Supp. 789 (N.D. Cal. 1987).
180. *See id.* at 796.
181. *Id.*

Mr. Kujawa's judgment was erroneous, but a subjective determination of materiality is not the appropriate standard. By sidestepping the issue of materiality, the Tenth Circuit inadvertently allowed a subjective test to enter into a materiality analysis, contrary to the general consensus of the other courts. A subjective test weakens the duty of candor by allowing possible breaches to be explained away simply because the attorney did not believe the information was material.

### D. *Conclusion*

Extending responsibility to the reexamintion requester is a step in the direction of increasing ethical behavior by attorneys. Moral responsibility is a desired trait. In practice, however, this responsibility could stifle the use of a beneficial new patent procedure. Without linking expanded participation in the reexamination proceeding with expanded responsibility, the rule loses power. Allowing a subjective test of materiality also eliminates some benefits from this rule.

## IV. Research and Development Costs: A Possible Actual Damage Figure for Copyright Infringement

Proving actual damages for copyright infringement is very difficult and often results in the copyright owner settling for statutory damages. In *Harris Marketing Research v. Marshall Marketing and Communications*,[182] the Tenth Circuit enumerated an alternative to proving actual damages: granting recovery for the development cost of a computer program. The absence of case law supporting this type of recovery suggests that attorneys often fail to ask for these damages.

### A. *Background*

The 1976 Copyright Act[183] lists the remedies available for copyright infringement. The purposes for awarding these damages include compensating the copyright owner for losses due to the infringement and preventing unjust enrichment for the copyright infringer.[184] Section 504(a) states an infringer of a copyright is liable for the copyright owner's actual damages and any additional profits of the infringer or statutory damages.[185] The 1976 Act alleviated conflict between the circuits as to the meaning of actual damages. Under the 1909 Act it was unclear whether the measure of actual damages included profits or if profit recovery was an alternative remedy.[186] The 1976 Act balanced the deterrent and compensatory approach by allowing the copyright

182. 948 F.2d 1518 (10th Cir. 1991).

183. 17 U.S.C. §§ 101-914 (1988).

184. H.R. Rep. No. 1476, 94th Cong., 2d Sess. 161 (1976), *reprinted in* 1978 U.S.C.C.A.N. 5659, 5777.

185. 17 U.S.C. § 504(a) (1988).

186. *Compare* Thomas Wilson & Co. v. Irving J. Dorfman Co., Inc., 433 F.2d 409 (2d Cir. 1907), *cert. denied*, 401 U.S. 977 (1971) (cumulative remedies) *with* Sid & Marty Krofft Television Prod., Inc. v. McDonald's Corp., 562 F.2d 1157 (9th Cir. 1977) (alternative remedies).

owner to recover actual damages and any profits not taken into account in determining the actual damages.[187] Section 504(b) describes the meaning of actual damages by explaining the procedure of proving the infringer's profits.[188] Congress gave copyright owners a choice of whether to seek statutory damages.[189] In electing statutory damages, the copyright owner can recover without having to prove economic harm.[190] Courts infer harm from the demonstration of a copyright infringement and have discretion to increase the award for any infringement committed willfully to a sum of not more than $100,000.[191] The release from having to prove actual damages makes this a very attractive alternative.[192]

The complexity of determining copyright infringement and appropriate damages increases in the area of computers and computer software. In 1980, Congress amended the 1976 Copyright Act to include computers in the general definition section of the Act.[193] This firmly placed computers and their programs within the realm of copyright protection.[194] Infringement of a computer program occurs when any of the exclusive rights specified in section 106 of the Act are violated.[195] Simply using a computer program also may constitute infringement.[196] Many computer software developers choose statutory

187. GOLDSTEIN, *supra* note 3, at 707.

188. The statute provides:

> The copyright owner is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages. In establishing the infringer's profits, the copyright owner is required to present proof only of the infringer's gross revenue, and the infringer is required to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.

17 U.S.C. § 504(b) (1988).

189. *Id.* § 504(c) (defining statutory damages as a range from not less than $500 to more than $20,000, as the court considers just).

190. ALLAN LATMAN, LATMAN'S THE COPYRIGHT LAW 283 (William F. Patry ed., 6th ed. 1986).

191. 17 U.S.C. § 504(c)(2).

192. LATMAN, *supra* note 190, at 283.

193. Pub. L. No. 96-517 § 10, 94 Stat. 3015, 3028 (Act of Dec. 12, 1980).

194. Whelan Assoc., Inc. v. Jaslow Dental Lab., Inc., 797 F.2d 1222 (3d Cir. 1986), *cert. denied*, 479 U.S. 1031 (1987).

195. Section 106 states:

> [T]he owner of a copyright under this title has the exclusive rights to do and to authorize any of the following:
>
> (1) to reproduce the copyrighted work in copies or phonorecords;
>
> (2) to prepare derivative works based upon the copyrighted work;
>
> (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
>
> (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly; and
>
> (5) in the case of literary, musical, dramatic and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly.

17 U.S.C. § 106 (1988).

196. L.J. KNUTTEN, COMPUTER SOFTWARE § 2.07 (1989); *see* Bly v. Banbury Books, Inc., 638 F. Supp. 983 (E.D. Pa. 1986).

damages when they discover infringement[197] for the following reasons: (1) proving actual damages is difficult; (2) infringers can easily escape detection; and (3) pursuing an intellectual property case is very expensive.[198]

Actual damage can be demonstrated in a variety of ways. The Copyright Act did not specifically define the nature of actual damages.[199] This often requires a court to estimate infringement damages.[200] Nevertheless, uncertainty about and a need to estimate damages does not prevent recovery.[201] Courts often use lost sales as a basis for determining damages for copyright infringement.[202] Courts utilize this measure when an infringer directly competes with the copyright owner.[203] In theory, the infringer displaced sales of the copyright owner and, therefore, must replace the lost sales.[204] Conversely, if an infringer indirectly competes with the owner, the court applies a reasonable royalty rate.[205] A reasonable royalty usually equals a previously granted license rate.[206] Finally, if the copyright owner has not previously licensed the copyright, the market value of the copyright at the time of the infringement becomes the measure of damages.[207]

The heart of calculating damages focuses on the extent that the market value of the copyright has been injured or destroyed by the infringement.[208] Courts look at indirect evidence bearing on the value because of the difficulty in making such a determination.[209] The owner of the intellectual property may testify as to its intrinsic value.[210] If a special value endows the work with greater than market value, a court looks at the nature of the work, its particular utility to the plaintiff and whether the work can be reproduced.[211]

1. Recovery of Development Costs

Few cases allow research and development costs as a form of actual damages. Courts, however, do not appear reluctant to grant this type of recovery. The absence of cases granting research and development costs is most likely connected to an absence of attorneys requesting them.

197. KNUTTEN, *supra* note 196, § 2.07[5][d].
198. PETER B. MAGGS ET AL., COMPUTER LAW 413 (1992).
199. 3 M. NIMMER & D. NIMMER, NIMMER ON COPYRIGHT § 14.02 (1992).
200. Universal Pictures Co. v. Harold Lloyd Corp., 162 F.2d 354 (9th Cir. 1947).
201. LATMAN, *supra* note 190, at 283.
202. Stevens Linen Assoc. v. Mastercraft Corp., 656 F.2d 11 (2d Cir. 1981).
203. GOLDSTEIN, *supra* note 3, at 707.
204. *Id.*
205. *Id.*
206. *See* Cream Records, Inc. v. Jos. Schlitz Brewing Co., 754 F.2d 826 (9th Cir. 1985).
207. *See* NIMMER, *supra* note 199, § 14.02, at 14-8 n.3. Nimmer notes that if the plaintiff's work had been infringed by another work prior to the defendant's infringement, the damages would be reduced. This tends to reduce the value of the copyright at the time of the defendant's infringement.
208. Fitzgerald Pub. Co. v. Baylor Pub. Co., Inc., 807 F.2d 1110, 1118 (2d Cir. 1986).
209. NIMMER, *supra* note 199, at § 14.02[A].
210. Universal Pictures Co. v. Harold Lloyd Corp., 162 F.2d 354, 369 (9th Cir. 1947).
211. NIMMER, *supra* note 199, at 14.02[A].

In *American Fabrics Co. v. Lace Art, Inc.*,[212] the United States District Court for the Southern District of New York hinted at the availability of research and development costs as an appropriate remedy. The court denied American Fabrics a preliminary injunction that would prevent Lace Art from selling its lace patterns due to an insufficient showing of irreparable harm.[213] American Fabrics complained that their high development costs afforded the copier an opportunity to undersell them.[214] The court found no reason why monetary damages would not serve as an adequate remedy for these costs; development costs provided a basis for monetary damages.[215]

More recently, the United States District Court for the Eastern District of Pennslyvania mentioned recovery of development costs for damages in a footnote.[216] The opinion stated that "a split produces two additional 3090 microcode copies . . . for which IBM may recover additional development costs and profits."[217] Finally, the United States District Court for the Eastern District of Louisiana allowed development costs in *Engineering Dynamics, Inc. v. Structural Software, Inc.*[218] In calculating actual damages for copyright infringement, the court gave an award that included costs to convert the owner's program into a program compatible with a personal computer.[219] The Tenth Circuit agreed that research and development costs provide an additional mode of recovery for copyright infringement in *Harris Market Research v. Marshall Marketing and Communications, Inc.*[220]

## B. Harris Market Research v. Marshall Marketing and Communications, Inc.[221]

### 1. Facts

Harris Marketing (Harris) developed a customized software program for Marshall Marketing and Communications (Marshall) to assimilate marketing information for television and radio stations for easier analysis. Marshall and Harris entered into a license and operating agreement (License Agreement) which allowed Marshall to sublicense the software to the individual stations.[222] The License Agreement required Marshall to pay Harris licensing and processing fees for use of the software.[223] With this agreement, "Harris Market expected to re-

212. 291 F. Supp. 589 (S.D.N.Y. 1968).
213. *Id.* at 592.
214. *Id.* at 591-92.
215. *Id.*
216. Allen-Myland, Inc. v. International Business Mach. Corp., 746 F. Supp. 520, 547 n.39 (E.D. Pa. 1990).
217. *Id.*
218. 785 F. Supp. 576 (E.D. La. 1991).
219. *Id.* at 584.
220. 948 F.2d 1518 (10th Cir. 1991).
221. *Id.*
222. *Id.* at 1521.
223. *Id.*

trieve license fees over seven years to amortize its investment . . . ."[224]

Marshall failed to make all scheduled payments prompting Harris to send a notice of intent to terminate the License Agreement.[225] After Marshall orally agreed to cure the payment default, Harris sent another letter agreeing to hold the termination at abeyance if Marshall met certain conditions. Harris contended Marshall did not meet the conditions and began contacting the television stations directly for payment of the license fee. Harris then became concerned when it did not immediately receive copies of the sublicense agreements on which the payment schedule for Marshall was based.[226] After receiving the agreements, Harris concluded it had not billed Marshall correctly so Harris sent another notice of termination and refused to undertake any new performance under the License Agreement.[227]

Harris brought an action for breach of the License Agreement and copyright infringement in Kansas District Court.[228] Marshall counterclaimed for breach of the License Agreement, misappropriation of proprietary information, interference with sublicense agreements, and malicious prosecution for the copyright infringement claim. Following a trial, a jury returned a special verdict finding Marshall liable for breach of the License Agreement and copyright infringement.[229] The jury found Harris liable for breach of the License Agreement, misappropriation of proprietary information, interference with sublicense agreements, and malicious prosecution for the copyright infringement claim.[230] This discussion focuses on whether the trial court abused its discretion by admitting Harris' development costs as proof of actual damages.

2. The Tenth Circuit Opinion

The Tenth Circuit held the trial court did not abuse its discretion by admitting evidence of Harris's development costs.[231] These damages are recoverable as copyright damages. The jury instruction explaining copyright damages stated that "the law allows a successful plaintiff to recover actual damages suffered as a result of the infringement *including unrecovered costs* and lost profits."[232] Marshall did not object to this jury instruction.

The court explained that Harris "expected to retrieve license fees over seven years to amortize its investment but was unable to recover its development costs."[233] The trial court correctly admitted the develop-

224. *Id.* at 1524.
225. *Id.* at 1521.
226. *Id.*
227. *Id.*
228. Harris Mkt. Research v. Marshall Mktg. & Communications, Inc., No. CIV.A.86-2491-S, 1990 WL 81044 (D. Kan. May 1, 1990).
229. *Id.* at *1.
230. *Id.*
231. *Harris Mkt. Research*, 948 F.2d at 1524.
232. *Id.* (emphasis in original).
233. *Id.*

ment cost amount. Reluctant to overturn evidentiary rulings of the trial court, the Tenth Circuit held it would not do so unless the trial court abused its discretion.[234]

C. *Analysis*

The most obvious effect of *Harris Market Research* is in the enumeration of an additional way to prove actual damages in a computer copyright action. Courts have acknowledged this measure of remedy in several other cases but not so clearly as in *Harris Market Research*.[235] The computer industry definitely benefits from this decision due to the high costs associated with developing both computers and software. Other industries, however, also may rely more on this form of actual damages. Allowing recovery for these damages furthers the purposes of enforcing copyright infringement. The damages compensate the individual for costs not taken into account when the court grants recovery of profits, and enhanced damages effectively deter infringers.

A problem with the court's decision occurs in the articulation of the remedy. The trial court admitted a summary of costs associated with developing the computer program.[236] Marshall objected to introduction of the summary of costs, but the trial court overruled the objection without any discussion.[237] The Tenth Circuit seems to authorize these damages without discussion[238] and without authority for this proposition. The court then focused on Jury Instruction 12 noting that it contained a provision for unrecovered costs. Marshall did not object to that specific instruction.[239] The court emphasized that fact, yet did not discuss that Marshall previously objected at the time the trial court admitted the evidence. Instead of firmly stating that Harris could recover development costs, the court ties the admittance to the ommission of objection on the part of Marshall. In doing so, the assurance of the remedy becomes clouded. Will an objection to an instruction on development cost damages remove the figure from the actual damages calculation? The Tenth Circuit did not clarify this issue.

*Harris Market Research* demonstrates what the Tenth Circuit requires to grant development costs as damages. Harris introduced a summary of the costs associated with developing that specific computer program.[240] The court then found that Harris was unable to recoup its development costs by retrieving license fees over several years.[241] Hence, the court will require very clear and precise evidence of unrecovered costs before granting this form of damage. This decision encourages industries to undertake costly advances in technology. The assurance of

234. *Id.*
235. *See supra* notes 208-16 and accompanying text.
236. *Harris Mkt. Research*, 948 F.2d at 1523.
237. *Id.*
238. *Id.* at 1524 (These damages are recoverable as copyright damages.).
239. *Id.*
240. *Id.* at 1523.
241. *Id.* at 1524.

recovery for these costs removes some of the risks involved in using initiative.

Although the case at first glance appears to be of little importance, it demonstrates to practitioners the need to ask the court for unusual damages, especially in the area of copyright infringement where actual damages are not defined. Creativity is not always common in the practice of law. This case suggests that the Tenth Circuit will allow unique damages for copyright infringement. However, it is not clear what effect an objection to those damages will have on the court's decision to grant or deny them.

## V. CONCLUSION

The intellectual property area has exploded to encompass a wide variety of areas. The three decisions discussed in this survey demonstrate some of the newest developments in intellectual property law. First, distinctive trade dress uniformly does not require secondary meaning for statutory protection. Second, patent reexamination, an additional way to challange patent validity, has extended the duties and responsibilities to the patent defender but also to the patent challenger. Third, a copyright owner can recover development costs from a copyright infringer.

For each decision that resolves an issue, more unanswered questions arise. These cases illustrate not only what courts have decided in these new areas but also what courts will need to decide in the future. Two prongs of the trade dress test still require definition. Additional procedures are needed to increase the usefulness of patent reexaminations. While copyright damages continue to evolve, the courts need to supply some concrete guidelines as to what measure of damages will be allowed. With an expansion of intellectual property rights comes a corresponding need for the courts and legislature to define those rights.

*Maria V. Woods*

# LANDS AND NATURAL RESOURCES SURVEY

## INTRODUCTION

Oil, gas and coal production drives the development of natural resources law in the Tenth Circuit. In *Doheny v. Wexpro Co.*,[1] the United States Court of Appeals for the Tenth Circuit ruled balancing in-kind is the preferred remedy for production imbalances on gas wells subject to joint operating agreements. In *Cheyenne-Arapaho Tribes of Okla. v. United States*,[2] The Tenth Circuit clarified the Secretary of the Interior's fiduciary duty to Indians in the approval of oil and gas leases. Both cases demonstrate that the court promotes mineral production when developing natural resources law. This Survey analyzes *Doheny* and concludes the court's decision wisely favors producers who deliver gas to the marketplace. The Survey also analyzes how the *Cheyenne-Arapaho Tribes* case will impact mineral leasing on Indian Lands. Finally, part III discusses standing doctrine as a procedural hurdle for parties objecting to exchanges of federal coal lands in the cases of *State ex rel. Sullivan v. Lujan*[3] and *Ash Creek Mining Co. v. Lujan*.[4]

## I. OIL AND GAS

### Gas Balancing Remedies in the Absence of a Balancing Agreement: *Doheny v. Wexpro Co.*[5]

### A. *Background*

Gas balancing arises in the production and marketing of natural gas and is a generic term for a class of various remedies used to offset production imbalances. Multiple parties often have a right to a partial share of gas production from a single well, lease or unitized area.[6] These parties become co-lessees in the specified area. Gas imbalances occur when a mineral co-lessee sells gas from the co-owned lease while another co-lessee with a right to a share of the production does not sell. Simply stated, "an imbalance occurs if someone who has a right to a portion of that stream does not take that portion."[7]

Numerous factors cause gas imbalances. A natural gas pipeline company may refuse to purchase gas from one or more of the unit lessees due to failure of the gas market,[8] or may employ discriminatory

1. 974 F.2d 130 (10th Cir. 1992).
2. 966 F.2d 583 (10th Cir. 1992).
3. 969 F.2d 877 (10th Cir. 1992).
4. 969 F.2d 868 (10th Cir. 1992).
5. 974 F.2d 130 (10th Cir. 1992).
6. Patrick H. Martin, *The Gas Balancing Agreement: What, When, Why, and How*, 36 ROCKY MTN. MIN. L. INST. § 13.01, at 13-3 (1990).
7. *Id.* § 13.02, at 13-8.
8. Edel F. Blanks, III et al., *A Primer On Gas Balancing*, 37 LOY. L. REV. 831, 833 (1992).

purchase practices against certain unit operators.[9] A working interest owner may refuse to sell natural gas at current market value in hopes of negotiating a future higher price.[10] The pipeline company may experience mechanical and engineering difficulties that prevent or delay connection to the production facility.[11]

When a party sells more than his share of the production, he has "overproduced," while the non-selling party has "underproduced."[12] If the parties own gas in common, as in a cotenancy, they owe a duty to account to one another for sale of the common gas. The failure to fulfill the duty is a failure to account, not a gas imbalance.[13] Conversely, gas balancing necessarily presupposes both a right to a definite share of the gas and a failure to take the gas actually produced.[14] In essence, gas balancing is the process by which overproduced and underproduced parties balance their respective shares of ownership to the produced gas by adjusting their take of future gas or through cash payments.[15]

Gas balancing problems arise when parties to a joint operating agreement fail to take gas in proportion to their ownership interest. Often the joint operating agreement does not include a balancing agreement.[16] When a dispute arises from a production imbalance in the absence of a formal balancing agreement, parties must agree on an acceptable balancing method. Principal methods are balancing in-kind, cash balancing and combined in-kind and cash balancing.[17] In-kind balancing allows the underproduced party to take a share of the overproduced party's gas until the parties are balanced.[18] Cash balancing requires the overproduced party to pay the underproduced party periodically or upon depletion of the gas-bearing formation until the pro-

9. Eugene Kuntz, *Gas Balancing Rights and Remedies in the Absence of a Balancing Agreement*, 35 ROCKY MTN. MIN. L. INST. § 13-01, at 13-3 (1990).

10. Martin, *supra* note 6, § 13.02, at 13-8.

11. *Id.*

12. Blanks et al., *supra* note 8, at 833.

13. Martin, *supra* note 6, § 13.02, at 13-10.

> The "production imbalance" approach is to be distinguished from a "true cotenancy" approach and from a "capture" approach. These two latter approaches have been urged on the courts. The "true cotenancy" approach postulates an ownership right in every molecule of gas, and any sale of the gas stream inures to the benefit or detriment of every party with an ownership interest. Failure to account for the value realized by a selling party would be keeping money that belongs to others. Such an approach must reject the idea that any party has a right to take a share in kind because everyone shares an ownership right in each and every molecule.

*Id.* § 13.02, at 13-8 to 13-9.

14. *Id.* § 13.02, at 13-9.

15. 8 HOWARD R. WILLIAMS & CHARLES J. MEYERS, MANUAL OF OIL AND GAS TERMS 84 (1992).

16. Gas production often occurs under an A.A.P.L. Model Form Operating Agreement. However, most model joint operating agreements do not contain balancing agreement provisions, which leads to balancing disputes between overproduced and underproduced co-lessees. David E. Pierce, *Taking Gas In Kind Absent a Balancing Agreement*, *in* THE OIL AND GAS JOINT OPERATING AGREEMENT pt. 9, at 9-1 (Mineral Law Series No. 2, 1990).

17. Blanks et al., *supra* note 8, at 838.

18. *Id.*; Pogo Producing Co. v. Shell Offshore, Inc., 898 F.2d 1064, 1066-67 (5th Cir. 1990); Beren v. Harper Oil Co., 546 P.2d 1356, 1359 (Okla. Ct. App. 1975).

duction imbalance is remedied.[19] The payment amount is usually based on the price the overproducing party received.[20] Disputes are commonly complicated by actual market price and the price the underproduced party would have received had she sold her gas.[21] Finally, under combined in-kind and cash balancing, the underproduced party receives in-kind balancing until the reservoir is depleted, at which time the overproduced party must pay the outstanding balance in cash.[22]

The attention to gas balancing in secondary authorities disproportionately outweighs case law on the subject.[23] Few cases lend definition to the doctrine of gas balancing; however, courts tend to agree on basic issues. Generally, courts to address the issue agree balancing in-kind is the preferred balancing remedy.[24] However, the courts willingly impose cash balancing where equities suggest balancing in-kind would detriment one of the parties. This usually arises when the overproduced party depleted the gas reservoir beyond the capacity to remedy the imbalance in-kind or the underproduced party is unable to accept delivery of the gas.[25] Courts do not consider a current low market price as an equity requiring cash balancing for an underproduced party.[26]

### B. *Tenth Circuit Opinion*

In *Doheny v. Wexpro Co.*,[27] the Tenth Circuit ruled that, unless conditions suggest otherwise, balancing in-kind is the preferred remedy to

19. *See, e.g.*, Kaiser-Francis Oil Co. v. Producer's Gas Co., 870 F.2d 563, 569 (10th Cir. 1989); WILLIAMS & MEYERS, *supra* note 15, at 85.

20. *Kaiser-Francis*, 870 F.2d at 569.

21. Blanks et al., *supra* note 8, at 838.

22. *Id.*

23. Martin, *supra* note 6, at 13-14 n.1 (citing numerous articles on gas balancing). *See also* 1 BRUCE M. KRAMER & PATRICK H. MARTIN, THE LAW OF POOLING AND UNITIZATION § 19.05, at 19-119 to 19-135 (3d ed. 1992) (gas balancing in the context of pooling and unitization); 6 HOWARD R. WILLIAMS & CHARLES J. MEYERS, OIL AND GAS LAW § 951 (1992) (comprehensive background of pooling and unitization relevant to balancing remedies); Theodore R. Borrego, *Gas Balancing Agreements Selected Problems and Issues*, 40 INST. ON OIL & GAS L. & TAX'N 4-1 (1989) (analysis and model gas balancing agreement); Bert L. Campbell, *Gas Balancing Agreements*, *in* OIL AND GAS AGREEMENTS pt. 9 (Mineral Law Series 1983) (sample gas balancing agreement and commentary); Haywood H. Hillyer, *Problems in Producing and Selling, By Split or Single Stream, Gas Allocable to Diverse Working Interest Ownerships*, 16 INST. ON OIL & GAS L. & TAX'N 243, 263-66 (1965) (detailed discussion of balancing in-kind); David L. Motloch, *Form 6 Gas Balancing Agreement*, *in* THE OIL AND GAS JOINT OPERATING AGREEMENT pt. 10 (Mineral Law Series No. 2, 1990) (discussing provisions of model gas balancing agreement); Thomas W. Niebrugge, *Oil and Gas: Production Imbalance in Split Stream Gas WellsGetting Your Fair Share*, 30 OKLA. L. REV. 955 (1977) (practical suggestions regarding problems encountered in gas balancing); Ernest E. Smith, *Gas Marketing By Co-Owners: Disproportionate Sales, Gas Imbalances and Lessors' Claims to Royalty*, 39 BAYLOR L. REV. 365 (1987) (contemporary gas marketing realities cause sales out of proportion to ownership interest thereby requiring gas balancing); Claude Upchurch, *Split Stream Gas Sales and the Gas Storage and Balancing Agreement*, 24 ROCKY MTN. MIN. L. INST. 665 (1978) (multiple interest owners and increased production necessitate gas balancing).

24. *Pogo Producing Co.*, 898 F.2d at 1067; United Petroleum Exploration, Inc. v. Premier Resources, Ltd., 511 F. Supp. 127, 131 (W.D. Okla. 1980); *Beren*, 546 P.2d at 1359.

25. *See Pogo Producing*, 898 F.2d at 1067; *United Petroleum*, 511 F. Supp. at 131; *Beren*, 546 P.2d at 1360.

26. *Pogo Producing*, 898 F.2d at 1067.

27. 974 F.2d 130 (10th Cir. 1992).

correct gas production imbalances in the absence of a formal gas balancing agreement.[28] Plaintiff-appellant Doheny sought review of an adverse district court ruling granting summary judgment to the defendants. The Tenth Circuit affirmed the lower court on all counts.[29]

Doheny (among others) was an interest holder in oil and gas leases in Sweetwater, Wyoming, referred to as the Trail Unit. Defendants were Wexpro, the gas well operator; Questar Pipeline Company, owner of the pipeline connected to the well; and Celsius Energy Company, BHP Petroleum and Mountain Fuel Supply Company, all three divided interest owners.[30] In 1958, Doheny entered a unit operating agreement with defendants to produce gas at the Trail Unit.[31] In 1987, Doheny entered a gas purchase agreement with Questar Pipeline Company's predecessor that allowed annual renegotiation of the gas purchase price, or contract cancellation if the parties could not agree on the price. In the summer of 1989, Doheny and Questar terminated the contract after failing to renegotiate the price.[32] After ceasing production during the summer, Wexpro resumed production for the other Trail Unit owners in the fall of 1989. All other Trail Unit interest owners except Doheny had contracts to sell their gas. Wexpro kept daily production records detailing the extent of Doheny's underproduction and the other interest owners' overproduction.[33]

Questar informed Doheny it would transport the plaintiffs' gas if Doheny could locate another purchaser. Wexpro subsequently provided plaintiffs with a list of seven regional natural gas marketers. However, Doheny failed to sell his gas.[34] Doheny maintained the cost of transporting gas through Questar's pipeline rendered any sales to third parties economically infeasible.[35]

Doheny filed suit against Wexpro, Questar and the other interest owners in June, 1990, in United States District Court for the District of Wyoming.[36] The complaint stated he was entitled to cash balancing to remedy his underproduction in the Trail Unit based on his cotenancy relationship with the other interest owners and Wexpro's fiduciary duties as operator.[37] On summary judgment motions, the district court ruled the proper remedy was balancing in-kind as opposed to cash balancing.[38] The lower court further ruled that the unit operating agree-

28. *Id.* at 134.
29. *Id.* at 135.
30. *Id.* at 131-32. Plaintiffs' minority interest in the Trail Unit well constituted an 8.2831% interest. Defendants' working interests were, respectively: Celsius Energy Company, 3.5529%; BHP Petroleum, Inc., 46.12099%; and Mountain Fuel Supply Company, 42.04301%.
31. *Id.* at 132. See the definition of unit operating agreement, *infra* notes 73-76 and accompanying text.
32. *Doheny*, 974 F.2d at 132.
33. *Id.*
34. *Id.* at 132-33.
35. *Id.*
36. *Id.* at 132.
37. *Id.*
38. *Id.* at 132-33.

ment did not create a cotenancy relationship, and Wexpro did not owe a fiduciary duty to Doheny requiring the operator to obtain a balancing agreement upon termination of plaintiff's purchase contract.[39]

On appeal, the Tenth Circuit ruled that balancing in-kind is the preferred method of the oil and gas industry unless circumstances indicate otherwise.[40] The court stated conditions requiring cash balancing are depletion of the well by the overproducer and physical inability of the underproduced party to accept gas in-kind, neither of which were present in this factual situation.[41] While the court recognized Doheny's valid interest in obtaining a favorable price for his gas, the court ruled such market price considerations do not justify imposing cash balancing on the overproducers.[42]

The court noted several policy considerations favoring balancing in-kind over cash balancing. Underproduced parties may be forced to sell their gas at a price they deem unacceptable if cash balancing is "universally and automatically applied."[43] Additionally, if after the fact interest owners could elect cash balancing over balancing in-kind, such discretionary license would foster speculation. Producers would choose to "take in-kind in a rising price market and to take the cash in a declining market."[44]

Based on a several liability clause and language referring to the interest owners' separate shares of production in the unit operating agreement, the Tenth Circuit ruled the working interest of the Trail Unit owners was not a cotenancy.[45] The lack of a cotenancy relationship among the interest owners foreclosed the remedy of a cash accounting.[46]

Doheny argued unsuccessfully before the district court that Wexpro's contract obligations created a fiduciary duty requiring the operating company to shut down production at the Trail Unit well until a gas balancing agreement was acquired once Doheny terminated his purchase agreement with Questar.[47] The Tenth Circuit affirmed the lower court and stated that based on elementary contract principles, no such fiduciary duty arose on Wexpro's part unless specifically set forth in the operating agreement.[48] Accordingly, Wexpro did not breach the contract since the contract contained no specific provision requiring Wexpro to obtain a gas balancing agreement on behalf of Doheny.[49]

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39. *Id.*
40. *Id.* at 133 (citing Pogo Producing Co. v. Shell Offshore, Inc., 898 F.2d 1064, 1067 (5th Cir. 1990); United Petroleum Exploration, Inc. v. Premier Resources, Ltd., 511 F. Supp. 127, 131 (W.D. Okla. 1980); Beren v. Harper Oil Co., 546 P.2d 1356, 1359 (Okla. Ct. App. 1975)).
41. *Id.*
42. *Id.* (citing *Pogo Producing*, 898 F.2d at 1067).
43. *Id.*
44. *Id.* at 133-34.
45. *Id.* at 134.
46. *See supra* notes 13-14 and accompanying text.
47. *Doheny*, 974 F.2d at 134-35.
48. *Id.* at 135.
49. *Id.*

C. *Analysis*

The Tenth Circuit's decision in *Doheny* recognized that in the absence of a balancing agreement, an underproducer may not pursue the most favorable economic remedy to the detriment of other working interest owners. In a sense, underproduced parties must accept gas in-kind to balance production because they failed to negotiate a favorable purchase contract with a pipeline company or other third-party buyer. Cash balancing too often provides a windfall for the non-diligent underproducer.[50] Balancing in-kind awards underproduced interest owners exactly what they are due: gas.

Cash balancing is most equitable when the underproduced party bears little or no responsibility for the imbalance. An overproducer who depletes the reservoir of natural gas to the detriment of other interest owners is literally unable to remedy the imbalance in-kind. A cash payment immediately and efficiently balances the account and penalizes the overproducing party for drinking too deeply at the well. Underproduced parties who cannot accept gas in-kind should receive cash to balance their underproduction only if they bear little culpability for the imbalance.

As the Tenth Circuit demonstrated, courts should guard against the inequities poised in the shadows of gas balancing remedies. An underproduced party may request balancing in-kind in a rising market and cash balancing when the market price of natural gas falls.[51] The overproduced party will favor the opposite remedy. Courts should disfavor such predatory opportunistic approaches by either party to balancing remedies, but should defer in favor of the overproducer in order to encourage production.

Balancing in-kind rightly favors the overproducer. While circumstances exist in which an underproducer would favor balancing in-kind over cash, the diligent overproducer is accountable to other interest owners in gas, *not* market price. An overproducer forced to balance in cash as a matter of uniform principle bears the burden of market variations more than the underproducer. The overproducer's success in negotiating favorable purchase contracts or diligently seeking untapped markets is distributed among the less diligent, less guarded underproducers who have failed to successfully market their gas. Cash balancing encourages a group of interest owners to unfairly profit from the success of any one co-interest owner without risking their own gas in the vagaries of the marketplace.

As a central tenet, oil and gas law favors production. In allocating benefit among producers, courts favor the party delivering gas to the marketplace. If underproducers could obtain either remedy at their discretion, underproducers would ride the slipstream of the successful overproducer who sells his gas at a high market price, or conversely de-

50. *Id.* at 133-34.
51. *Id.*

mand gas in-kind for past imbalances in a market of climbing natural gas price. Setting forth balancing in-kind as the standard remedy for production imbalances places the risk of loss disproportionately on the underproducer and the opportunity for advantage on the overproducer in order to favor production.

Parties to joint operating agreements should include a gas balancing agreement. Expense and disputes arising in the absence of a formal balancing agreement are avoided through careful selection of gas balancing remedies at the onset of a joint operating agreement. Obviously, parties who understand the inherent advantages of various balancing methods may employ them to their respective benefit at the contract negotiation stage.[52]

## II. INDIAN LAW[53]

Fiduciary Duty of the Secretary of the Interior: *Cheyenne-Arapaho Tribes of*

52. For an excellent account of the provisions in a model gas balancing agreement, see Motloch, *supra* note 23.

53. Cases decided by the Tenth Circuit in 1992 demonstrate that the court continues to develop Indian law. In addition to the *Cheyenne-Arapaho Tribes of Okla.* case which is the subject of this portion of this survey, the Tenth Circuit decided several other cases involving Indian law. However, these decisions are less significant since they involve well-settled areas of Indian law such as the immunity of Indians from state taxing authorities and the sovereign immunity of tribal businesses from litigation in federal courts.

The Tenth Circuit decided two cases concerning Indian immunity from state taxing authorities: Citizen Band Potawatomi Indian Tribe of Okla. v. Oklahoma Tax Comm'n, 969 F.2d 943 (10th Cir. 1992) (Indian tribe not immune from legal obligation to collect state tax on sales of cigarettes to non-tribal members on reservation; however, sovereign immunity bars federal court enforcement action) and; Sac & Fox Nation v. Oklahoma Tax Comm'n, 967 F.2d 1425 (10th Cir. 1992) (state tax authority could collect income tax from non-member employees of tribe but lacked authority to collect taxes from tribal members employed by tribe).

According to settled Indian law, tribes are immune from state tax authorities. *See generally* California v. Cabazon Band of Mission Indians, 480 U.S. 202 (1987) (State of California may tax Indians on Tribal lands only if Congress consents); Montana v. Blackfeet Tribe of Indians, 471 U.S. 759 (1985) (State of Montana may not tax royalty interest of Indian tribe from mineral development on tribal lands); Moe v. Confederated Salish & Kootenai Tribes of Flathead Reservation, 425 U.S. 463 (1976) (State of Montana cigarette sales tax and personal property tax on automobiles invalid as applied to Indians on reservation); McClanahan v. Arizona State Tax Comm'n, 411 U.S. 164 (1973) (State of Arizona lacked jurisdiction to tax income of Navajo Indians residing on the Navajo Reservation whose income was wholly derived from reservation sources); FELIX S. COHEN, HANDBOOK OF FEDERAL INDIAN LAW 254-55 (1986) (overview of limitations on state taxing authorities regarding Indian tribes); JAY VINCENT WHITE, TAXING THOSE THEY FOUND HERE 33-52 (1972) (legal history of federal instrumentality doctrine prohibiting state taxation of lands held in trust); CHARLES F. WILKINSON, AMERICAN INDIANS, TIME, AND THE LAW 96-99 (1987) (analysis of case law construing immunity of tribes from state taxation); Clydia J. Cuykendall, Recent Development, 49 WASH. L. REV. 191 (1973) (federal preemption of taxation analyzed in light of Indian sovereign immunity).

The Tenth Circuit also decided two cases that support the well-founded doctrine that Indian tribes enjoy sovereign immunity: Bank of Okla. v. Muscogee (Creek) Nation, 972 F.2d 1166 (10th Cir. 1992) (tribal sovereign immunity bars federal court interpleader action against tribal business); *Citizen Band*, 969 F.2d at 943 (tribal sovereign immunity bars enforcement in federal court of tribal obligation to collect state tax on sales of cigarettes to nontribal members on reservation).

It is a well-settled doctrine of Indian law that tribes enjoy sovereign immunity. *See generally* Oklahoma Tax Comm'n v. Citizen Band Potawatomi Indian Tribe of Okla., 498 U.S. 505 (1991) (Indian tribe immune from state taxes on cigarette sales on reservation);

*Okla. v. United States*[54]

A. *Background*

The Supreme Court first recognized the existence of a trust relationship between the federal government and Indian tribes in early decisions interpreting treaties.[55] The United States entered hundreds of treaties with tribes between 1787 and 1871 in which the tribes gave up land in exchange for promises from the government.[56] Generally, the treaties promised that the federal government would create permanent reservations for the tribes and protect and safeguard the health and well-being of the Indians.[57]

Chief Justice Marshall provided a conceptual basis for the trust between Indian tribes and the government by describing the relationship in guardian-ward terms. Indian tribes are in a state of pupilage. Their relation to the United States resembles that of a ward to his guardian.[58] Half a century later, the Court recognized that treaties with Indian tribes promised protection by the federal government and thereby created a formal fiduciary relationship.[59] The basis for the fiduciary relationship

Washington v. Confederated Tribes of Colville Indian Reservation, 447 U.S. 134 (1980) (State of Washington may tax sale of cigarettes to non-tribal members on reservation, but tribal sovereign immunity bars state taxation of sales to tribal members), *reh'g denied*, 448 U.S. 911 (1981); Santa Clara Pueblo v. Martinez, 436 U.S. 49 (1978) (tribal sovereign immunity barred suit in federal court against Indian tribe by tribal member under Indian Civil Rights Act); Tillett v. Lujan, 931 F.2d 636 (10th Cir. 1991) (tribal sovereign immunity requires exhaustion of tribal court remedies before pursuit of suit against tribal member in federal court); Superior Oil Co. v. United States, 798 F.2d 1324 (10th Cir. 1986) (tribal sovereign immunity requires exhaustion of tribal court remedies before oil company may instigate suit against tribe in federal court); VINE DELORIA, JR. & CLIFFORD M. LYTLE, THE NATIONS WITHIN: THE PAST AND FUTURE OF AMERICAN INDIAN SOVEREIGNTY (1984) (excellent political and social history of tribal sovereign immunity); GEORGE S. GROSSMAN, THE SOVEREIGNTY OF AMERICAN INDIAN TRIBES: A MATTER OF LEGAL HISTORY (Matthew Stark ed., 1979) (concise summary of Indian sovereign immunity); Ralph W. Johnson & James M. Madden, *Sovereign Immunity in Indian Tribal Law*, 12 AM. INDIAN L. REV. 153 (1984) (detailed summary of statutory and case law regarding tribal sovereign immunity); Frederick J. Martone, *American Indian Tribal Self-Government in the Federal System: Inherent Right or Congressional License?*, 51 NOTRE DAME L. REV. 600 (1976) (arguing status of Indian tribes is based on federal preemption of state law, not true sovereign immunity); Steve E. Dietrich, Comment, *Tribal Businesses and the Uncertain Reach of Tribal Sovereign Immunity: A Statutory Solution*, 67 WASH. L. REV. 113 (1992) (statutory remedy proposed to alleviate problems sovereign immunity creates for commercial tribal ventures).

54. 966 F.2d 583 (10th Cir. 1992).

55. *See, e.g.*, Worcester v. Georgia, 31 U.S. 515 (1832); Cherokee Nation v. Georgia, 30 U.S. 1 (1831).

56. *See* COHEN, *supra* note 53, at 46-66.

57. STEPHEN L. PEVAR, THE RIGHTS OF INDIANS AND TRIBES 38 (2d ed. 1992).

58. *Cherokee Nation*, 30 U.S. at 17.

59. These Indian tribes are the wards of the nation. They are communities dependent on the United States. Dependent largely for their daily food. Dependent for their political rights. They owe no allegiance to the States, and receive from them no protection. Because of the local ill feeling, the people of the States where they are found are often their deadliest enemies. From their very weakness and helplessness, so largely due to the course of dealing of the Federal Government with them and the treaties in which it has been promised, there arises the duty of protection, and with it the power. This has always been recognized by the Executive and by Congress, and by this court, whenever the question has arisen.

United States v. Kagama, 118 U.S. 375, 383-84 (1886)(upholding congressional power to confer federal jurisdiction over crimes committed on Indian reservations); *see also* United

is literally trust: the tribes trust the United States to fulfill its treaty obligations given in exchange for Indian lands.[60] While the general duties arising out of a treaty require the United States to meet the rigorous standards of a fiduciary,[61] treaty obligations lack specificity in areas of narrow subject matters such as natural resources development.

In addition to treaty-based fiduciary responsibilities, the Supreme Court has held the federal government acts as a fiduciary to Indians on statutory and regulatory grounds. Federal statutory law creates a fiduciary relationship in the same manner as a treaty. Express statutory language requires the United States to regulate, control or protect Indian natural resources and lands for tribal benefit and imposes specific duties and trust obligations on the federal government.[62] Where courts base fiduciary obligations on subject matters regulated by statutory schemes, the government must act with a high degree of care and responsibility.[63] The more pervasive and encompassing the federal agency regulation and control of Indian resources, the greater the trust responsibility.[64] Where a federal agency as trustee mismanages tribal resources and injures the tribe as beneficiary, the trust relationship necessarily permits

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States v. Sandoval, 231 U.S. 28 (1913)(recognizing that congressional legislation prohibiting alcohol on Indian reservation is validly based on government's guardianship over Indians).

60. For additional background on the trust relationship doctrine, see generally COHEN, *supra* note 53, at 169-73 (trustee/beneficiary aspects of "wardship" status of Indians); Nancy Carol Carter, *Race and Power Politics as Aspects of Federal Guardianship Over American Indians: Land Related Cases, 1887-1924*, 4 AM. INDIAN L. REV. 197 (1976) (survey of Indian lands cases over 50-year period recognizing federal fiduciary duty to tribes); Reid Peyton Chambers, *Judicial Enforcement of the Federal Trust Responsibility to Indians*, 27 STAN. L. REV. 1213 (1975) (congressional statutory intent mandates executive branch act as trustee to Indian tribes).

61. In 1942, in an action for breach of fiduciary duties arising from treaty obligations, the Supreme Court cited numerous prior decisions and described in moral terms the nature of the fiduciary relationship:

> In carrying out its treaty obligations with the Indian tribes the Government is something more than a mere contracting party. Under a humane and self-imposed policy . . . it has charged itself with moral obligations of the highest responsibility and trust. Its conduct, as disclosed in the acts of those who represent it in dealings with the Indians, should therefore be judged by the most exacting fiduciary standards.

Seminole Nation v. United States, 316 U.S. 286, 296-97 (1942).

Although fiduciary obligations elude concise summary, fiduciaries must act selflessly in their wards' best interest, and give them the benefit of special knowledge, skill and expertise. Courts demand fiduciaries to act in good faith and avoid self-dealing and conflicts of interest. *See, e.g.*, Austin W. Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 539-45 (1949)(well-written exposition of fiduciary principles applicable to range of relationships).

62. The Secretary of the Interior is authorized to manage timber sales, oil and gas development and mineral leasing on Indian lands. 25 U.S.C. §§ 391-416 (1988 & Supp. II 1991). *See* United States v. Mitchell, 463 U.S. 206 (1983)(statutes and regulations requiring the United States to manage Indian timber resources for tribal benefit creates common law trust that renders government liable in damages for breach of fiduciary duties).

63. *Mitchell*, 463 U.S. at 206; Jicarilla Apache Tribe v. Supron Energy Corp., 782 F.2d 855 (10th Cir. 1986)(en banc), *adopting in relevant part*, Jicarilla Apache Tribe v. Supron Energy Corp., 728 F.2d 1555, 1563-73 (10th Cir. 1984)(Seymour, J., dissenting), *cert. denied*, 479 U.S. 970 (1986).

64. *See, e.g.*, *Mitchell*, 463 U.S. at 224-25; Navajo Tribe of Indians v. United States, 624 F.2d 981, 986 (Ct. Cl. 1980).

the tribe to sue the trustee agency for damages resulting from the breach of fiduciary obligations.[65]

Tribal entities aggrieved by agency action may sue under provisions of the Administrative Procedure Act (APA) to obtain injunctive or declaratory relief.[66] Generally, federal courts will set aside only that agency action that is arbitrary and capricious, or not in accordance with the law. Under principles of administrative law, an agency must consider relevant factors and consequences regarding its administrative decision and support the action with an administrative record that ventilates the major issues of policy and fact. Although courts defer to agencies upon judicial review, the administrative record must demonstrate the agency weighed the facts and alternatives and based its action on reasonable conclusions.[67]

B. *Tenth Circuit Opinion*

In *Cheyenne-Arapaho Tribes of Okla. v. United States*,[68] the Tenth Circuit recognized that fiduciary duties constrain the Secretary of the Interior's (Secretary) discretion to approve oil and gas leases on tribal lands. The court ruled that the Secretary breached his duties as a fiduciary when he failed to consider relevant factors, including current market and economic conditions, before approving communitization agreements.[69] The court reviewed the district court's summary judgment ruling overturning the Bureau of Indian Affairs' (BIA) 1981 decision. The BIA approved two communitization agreements unitizing oil and gas operations on two spacing units owned by the Cheyenne-Arapaho Tribes of Oklahoma (Tribe) in Custer County, Oklahoma.

Woods Petroleum Company and Reading and Bates Petroleum Company (Companies) owned a total of six oil and gas leases originally approved by the BIA on Tribal lands.[70] The lease terms included commence drilling clauses that extended the lease duration if drilling initiated before the leases expired on May 10, 1981.[71] The leases also included unit operating clauses that allowed the parties to communitize the gas field as one operating unit if adopted by a majority of the operat-

65. *See Mitchell*, 463 U.S. at 225 n.31.

66. 5 U.S.C. §§ 500-590 (1988 & Supp. III 1992). *See generally* PEVAR, *supra* note 57, at 320-22 (providing discussion of judicial review of administrative actions affecting Indians and tribal entities).

67. *See, e.g.*, Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402 (1971)(record maintained contemporaneous with agency decision-making necessary to survive judicial review when challenged); Home Box Office, Inc. v. FCC, 567 F.2d 9 (D.C. Cir. 1977)(agency action arbitrary and capricious where administrative record failed to disclose secret and undocumented ex parte contacts between agency and those affected by agency action), *cert. denied*, 434 U.S. 829 (1977); United States v. Nova Scotia Food Products Corp., 568 F.2d 240 (2d Cir. 1977)(agency regulation void as arbitrary and capricious where data upon which regulation was based was not publicized and comments of interested parties who submitted contrary evidence went unaddressed in record by agency).

68. 966 F.2d 583 (10th Cir. 1992).

69. *Id.* at 589-90.

70. *Id.* at 584-85.

71. *Id.* at 585.

ing interests and approved by the Secretary.[72]

Under a communitization agreement, gas production anywhere on a gas field is deemed to occur on each lease within the communitized area.[73] Communitization is a synonym for unitization. This term denotes the joint operation of all or a portion of a petroleum reservoir subject to different ownership interests.[74] Unitization functions as a conservation measure by which few wells are drilled and operated in the unitized area in order to prevent waste, maintain reservoir pressures and best use secondary recovery techniques.[75] Unitization is often the only manner by which production from numerous tracts overlying a common reservoir is economically feasible.[76]

A communitization agreement in conjunction with the commence drilling clause would extend the duration of all the leases on the Tribe's lands if drilling commenced on any single lease within the communitized area despite the termination date.[77] Three weeks prior to the May 10, 1981, termination date, the Companies decided to communitize the leases and requested approval from the Tribe.[78] Tribal business representatives met with the Companies and local BIA officials and refused to approve the communitization agreements unless the leases were renegotiated to provide a $1,500 per acre lease bonus and a ten percent back-in working interest to the Tribe.[79] The Companies rejected renegotiations of the leases and threatened litigation unless the Tribe assented to the communitization agreements.[80] On the grounds that the agreements adequately protected the Tribe's limited interests, the United States Geological Survey recommended that the BIA approve the communitization agreements.[81] On May 8, 1981, just two days before the Companies' leasehold interests in the oil and gas field would expire, the

72. *Id.* A unit operating clause is the provision in a lease which permits the parties to enter a unit operating agreement. The latter is defined as "[a]n agreement or plan of development and operation for the recovery of oil and gas made subject thereto as a single consolidated unit without regard to separate ownership and for the allocation of costs and benefits on a basis as defined in the agreement or plan." WILLIAMS & MEYERS, *supra* note 15, at 1315.

73. *See, e.g.*, Kenai Oil & Gas, Inc. v. Dep't of the Interior, 671 F.2d 383, 384 (10th Cir. 1982). *See also* WILLIAMS & MEYERS, *supra* note 15, at 921-24.

74. WILLIAMS & MEYERS, *supra* note 15, at 1317-18.

75. *Id.*

76. *See, e.g.*, KRAMER & MARTIN, *supra* note 23, § 1.01, at 1-1 to 1-3.

77. *Cheyenne-Arapaho Tribes*, 966 F.2d at 585.

78. *Id.*

79. *Id.* A lease bonus is broadly defined as "the cash consideration paid by the lessee for the execution of an oil and gas lease by a landowner." WILLIAMS & MEYERS, *supra* note 15, at 114. The lease bonus acts as an incentive in unitization negotiations involving reluctant interest owners such as the Tribe. *See* Charles Nesbitt, *A Primer on Forced Pooling of Oil and Gas in Oklahoma*, 50 OKLA. B.J. 648, 650 (1979).

A back-in working interest may, like a lease bonus, induce reluctant owners to consent to unitization. A back-in working interest allows land-owners to regain a working interest in a well after it has been proven tobe successful. Accordingly, a back-in working interest can be significantly more lucrative than a lease bonus. A back-in working interest is often given as incentive to an operating owner affected by unitization. WILLIAMS & MEYERS, *supra* note 15, at 81.

80. *Cheyenne-Arapaho Tribes*, 966 F.2d at 585.

81. *Id.*

Acting Area Director of the Anadarko Office of the BIA approved the communitization agreements.[82]

The Tribe sought administrative review of the BIA action,[83] and ultimately filed action against the United States, the BIA and the Department of the Interior in the United States District Court for the Western District of Oklahoma. The complaint challenged the BIA's authority to approve the communitization agreements and extend the terms of the oil and gas leases.[84] The district court concluded the unit operation clause in the leases did not require consent from the Tribe in order to activate the communitization agreements. However, the court held the Acting Area Director of the BIA breached his fiduciary trust obligations to the Tribe under statutes regulating Department of Interior mineral leasing on Indian lands[85] by approving the communitization agreements without first examining prevailing market and economic conditions.[86] This breach of trust by the Secretary's representative rendered invalid the communitization agreements regarding the leases on which the Companies had not commenced drilling. The leases terminated upon expiration of their primary terms.[87]

The Tenth Circuit granted Woods Petroleum Company's petition for interlocutory appeal and the Tribe's petition for cross-appeal.[88] The court dismissed the Companies' claim that the Tribe's administrative appeal was time barred and pointed out that the administrative appeal was timely as the regulation at issue[89] required written notice to the Tribe of the BIA action.[90] Since the Tribe never received written notice of the BIA approval of the communitization agreements, the Tribe's right to appeal was never time barred.[91]

The Companies also maintained the district court considered irrelevant factors in concluding the Secretary was constrained by its fiduciary duty in the approval of the communitization agreements.[92] The Tenth Circuit disagreed and outlined the statutory and regulatory framework that mandates discretionary approval by the Secretary of communitization agreements of oil and gas leases on Indian lands.[93] The Mineral Leasing Act required the Secretary to promulgate rules and regulations

82. *Id.*

83. In sequence, the Deputy Assistant Secretary of the Department of the Interior and the BIA affirmed the Anadarko Area Director's approval of the communitization agreements. *Id.* at 586.

84. *Id.* Due to an insufficient record, the district court remanded the case to the Secretary, whose response to the Order of Remand provoked a round of summary judgment motions from the parties.

85. Mineral Leasing Act of 1938, 25 U.S.C. §§ 396(a)-(g) (1988)(statutory scheme setting forth Secretary's role in mineral leasing on Indian lands).

86. *Cheyenne-Arapaho Tribes*, 966 F.2d at 586.

87. *Id.*

88. *Id.* at 584.

89. 25 C.F.R. § 2.7(b) (1992)(right to appeal agency action or decision continues until agency gives written notice).

90. *Cheyenne-Arapaho Tribes*, 966 F.2d at 587.

91. *Id.*

92. *Id.* at 588.

93. *Id.*

regarding mineral leasing of Indian lands and directed that the Secretary in his discretion approve reasonable unit operating agreements.[94] These regulations required the Secretary's approval of cooperative agreements such as the communitization agreements.[95] The court held that despite the absence of express statutory or regulatory language, the Secretary acts as a fiduciary to the Indians, and "the United States' function as a trustee over Indian lands necessarily limits the Secretary's discretion to approve communitization agreements."[96] The court affirmed the principle that whenever the government controls Indian properties or monies, the United States acts as a fiduciary to the tribe.[97] Relying on the Mineral Leasing Act and Department of Interior regulations, which require Secretary approval of oil and gas leases and communitization agreements, the court stated that a fiduciary relationship arises between the Secretary and the Tribe because of the government's pervasive role in oil and gas leasing on Indian lands.[98]

The Secretary's discretion to approve oil and gas leases and communitization agreements is limited by fiduciary standards which necessarily include the duty to maximize lease revenues and safeguard the economic interests of the Tribe.[99] On administrative review, the Secretary's action must meet the demanding standards of a fiduciary, not just the minimal requirements of administrative review.[100] Applying these standards, the court held that when the BIA originally approved the communitization agreements, the Acting Area Director failed to consider relevant economic factors, including marketability and market value of the leases if renegotiated.[101] Affirming the district court's finding, the Tenth Circuit held the failure to consider economic conditions was arbitrary and capricious, an abuse of discretion and a breach of the Secretary's fiduciary duties to the Tribe.[102] Accordingly, the court ruled the communitization agreements approved by the BIA were invalid and

94. All operations under any oil, gas, or other mineral lease issued pursuant to the terms of sections 396 a to 396g of this title or any other Act affecting restricted Indian lands shall be subject to the rules and regulations promulgated by the Secretary of the Interior. In the discretion of the said Secretary, any lease for oil or gas issued under the provisions of sections 396a to 396g of this title shall be made subject to the terms of any reasonable cooperative unit or other plan approved or prescribed by said Secretary prior or subsequent to the issuance of any such lease which involves the development or production of oil or gas from land covered by such lease.

Mineral Leasing Act, 25 U.S.C. § 396(d) (1988).

95. All such leases shall be subject to any cooperative or unit development plan affecting the leased lands that may be required by the Secretary of the Interior, but no lease shall be included in any cooperative or unit plan without prior approval of the Secretary of the Interior and consent of the Indian tribe affected.

25 C.F.R. § 171.21(b) (1981)(repromulgated at 25 C.F.R. § 211.21(b) (1992)).

96. *Cheyenne-Arapaho Tribes*, 966 F.2d at 588.

97. *Id.* at 588 (citing Navajo Tribe of Indians v. United States, 624 F.2d 981 (1980)).

98. *Id.* (citing Mitchell v. United States, 463 U.S. 206, 225 (1983)).

99. *Id.* at 589.

100. *Id.* at 590-91 (citing Jicarilla Apache Tribe v. Supron Energy Corp., 728 F.2d 1555, 1563 (10th Cir. 1984)(Seymour, J., concurring in part and dissenting in part), *dissenting opinion adopted as the majority opinion as modified*, 782 F.2d 855 (10th Cir. 1986)).

101. *Id.*

102. *Id.* at 591.

any leases upon which drilling had not commenced by May 10, 1981, terminated on that date.[103]

C. *Analysis*

The Tenth Circuit's decision in *Cheyenne-Arapaho Tribes* defines the role of the Secretary in mineral leasing on Indian Lands. As trustee, the Secretary must consider all factors in oil and gas leases relevant to the best interests of the beneficiary Tribe. After *Cheyenne-Arapaho Tribes*, failure to consider the Indians' economic interest in aggregate with social, environmental and conservation factors renders BIA action regarding mineral leasing both arbitrary and capricious on administrative review under the APA and a breach of fiduciary duty.[104]

The BIA may not solely consider the conservation interests inherent in any unitization agreement on Indian lands, but must examine whether unitization serves the Tribe's economic interests. If oil and gas lease values significantly rise, renegotiation of lease terms at higher rates better serves the Tribe. Despite conservation benefits realized through unitization of oil and gas fields, the Tenth Circuit decision demonstrates that economics may trump conservation concerns. Indians aggrieved by administrative action that constitutes a breach of the trust responsibility may obtain damages from the agency in addition to injunctive and declaratory relief under the APA. Based on the pervasive role of the Department of the Interior and the BIA in the regulation of mineral leasing on Indian lands, the fiduciary obligations of the Secretary are rigorous and demanding.[105]

The Tenth Circuit differentiated between the general trust responsibility arising from treaty obligations and the subject-specific fiduciary duties arising in the context of mineral leasing supervised by the Secretary under the Mineral Leasing Act and implementing regulations. Although treaty obligations create a general trust relationship between the United States and the Indians, obligations based on a statutory and regulatory framework demand that agencies meet the exacting standards of a fiduciary at every stage of agency participation.[106] After *Cheyenne-Arapaho Tribes*, agency officials administering mineral development and production on Indian lands held in trust must seriously consider the best interest of the Indians regarding the maximum revenue-producing use of the lands. As fiduciary, the Secretary should treat Tribal mineral development as an investment under the stewardship of the Department of the Interior. *Cheyenne-Arapaho Tribes* demonstrates a judicial willingness to force the Secretary as common-law fiduciary to justify the revenue produced by specific leases on Tribal mineral lands.

However, the fiduciary standard set forth in *Cheyenne-Arapaho Tribes* is ultimately no more rigorous than that demanded of all agencies under

103. *Id.*
104. *Id.*
105. *See supra* notes 59-61 and accompanying text.
106. *Cheyenne-Arapaho Tribes*, 966 F.2d at 591.

the APA and *Citizens to Preserve Overton Park, Inc. v. Volpe*.[107] Upon judicial review, the Secretary may satisfy the fiduciary standard by exhibiting an administrative record which simply considers the Tribe's economic interests. Such a record is sufficient to pass scrutiny under *Overton Park*. The Secretary simply failed to even consider the Tribe's economic best interest when the BIA reviewed the communitization agreements. Although the court framed the Secretary's obligations in substantive fiduciary terms, the net effect is, ultimately like all administrative exercises, procedural. The Secretary's actions would most likely have withstood legal challenge if the BIA had conducted an exercise in administrative record building that justified how the Tribe's economic best interests are served by renewing the communitization agreements.

In historical context, the United States has rarely met even the contractual treaty obligations promised Indian tribes.[108] Review of administrative action that requires the executive branch to act as a common-law fiduciary to the Indians or risk judicial censure appears to demand the United States to honor obligations long ignored and attempts to prospectively remedy an historic injustice of appalling proportions. The fiduciary obligations recognized in *Cheyenne-Arapaho Tribes* are, however, ultimately procedural. Challengers or defenders of BIA action regarding minerals development on Tribal lands should strategize as in any administrative action under the APA.

## III. PUBLIC LANDS

Standing to Sue When Challenging Public Lands Exchanges: A Procedural Hurdle: *State ex rel. Sullivan v. Lujan*;[109] *Ash Creek Mining Co. v. Lujan*.[110]

### A. *Background*

Article III, § 2, of the Constitution limits the judicial power of federal courts to the resolution of "cases" and "controversies."[111] Standing doctrine arises out of the case and controversy limitation on the scope of judicial authority and serves to ensure that the party seeking relief has established such a personal interest in the controversy as to "assure that concrete adverseness which sharpens the presentation of issues."[112] Reduced to the minimum, standing identifies disputes ap-

107. 401 U.S. 402 (1971).
108. *See* COHEN, *supra* note 53, at 46-66; PEVAR, *supra* note 57, at 38.
109. 969 F.2d 877 (10th Cir. 1992).
110. 969 F.2d 868 (10th Cir. 1992).
111. Article III, § 2, cl. 1 provides:
> The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority;to all Cases affecting Ambassadors, other public Ministers and Consuls;to all cases of admiralty and maritime Jurisdiction;to Controversies to which the United States shall be a Party;to Controversies between two or more States;between a State and Citizens of another state;between Citizens of different States;between Citizens of the same State claiming Lands under the Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.

112. Flast v. Cohen, 392 U.S. 83, 94, 99 (1968). Chief Justice Warren explained in *Flast*:

propriate to judicial resolution.[113] Any party seeking relief in federal court must establish standing in order to challenge the action at issue in the lawsuit.[114] The Supreme Court recently demonstrated that litigants who ignore standing requirements do so at their peril.[115]

The Supreme Court set forth the constitutional essence of standing as three elements that a party seeking relief must establish: injury in fact, causation and redressability.[116] First, an injury in fact must be discrete, concrete, specific and actual or imminent.[117] A conjectural or hypothetical injury is insufficient to sustain standing.[118]

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> [I]n terms of Article III limitations on federal court jurisdiction, the question of standing is related only to whether the dispute sought to be adjudicated will be presented in an adversary context and in a form historically viewed as capable of judicial resolution. It is for that reason that the emphasis in standing problems is on whether the party invoking federal court jurisdiction has "a personal stake in the outcome of the controversy," and whether the dispute touches upon "the legal relations of parties having adverse legal interests."

*Id.* at 101 (citations omitted).

113. *See, e.g.*, Whitmore v. Arkansas, 495 U.S. 149, 155 (1990). Standing doctrine has engendered a vast array of commentary. *See* LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 78 (2d ed. 1988); 13 CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE § 3531 (2d ed. 1984)(constitutional foundation of standing doctrine); Roger Beers, *Standing and Related Procedural Hurdles in Environmental Litigation*, 1 J. ENVTL. L. & LITIG. 65 (1986)(arguing that careful plaintiff selection and exhaustion of administrative remedies surmount standing difficulties encountered in environmental litigation); Kevin A. Coyle, *Standing of Third Parties To Challenge Administrative Agency Actions*, 76 CAL. L. REV. 1061 (1988)(causation element of standing doctrine should be abandoned in administrative actions on behalf of third parties); Robert Dugan, Comment, *Standing To Sue: A Commentary on Injury in Fact*, 22 CASE W. RES. L. REV. 256, 257 (1971)(maintaining injury in fact is the primary element of the tripartite standing test); William A. Fletcher, *The Structure of Standing*, 98 YALE L.J. 221 (1988); Marla E. Mansfield, *Standing and Ripeness Revisited: The Supreme Court's "Hypothetical" Barriers*, 68 N.D. L. REV. 1 (1992); Gene R. Nichol, Jr., *Abusing Standing: A Comment on* Allen v. Wright, 133 U. PA. L. REV. 635 (1985)(Supreme Court concern with separation of powers evinced in standing opinions furthers agenda of judicial activism); Gene R. Nichol, Jr., *Rethinking Standing*, 72 CAL. L. REV. 68 (1984)(less confusing and obfuscated standing doctrine provides better access to federal courts for deserving claimants); Jonathan Poisner, *Environmental Values and Judicial Review After Lujan: Two Critiques of the Separation of Powers Theory of Standing*, 18 ECOLOGY L.Q. 335 (1991); Antonin Scalia, *The Doctrine of Standing as an Essential Element of the Separation of Powers*, 17 SUFFOLK U. L. REV. 881 (1983)(arguing standing is a central and indispensable tenet of the principle of separation of powers); Kurt S. Kusiak, Note, *Standing to Sue: A Brief Review of Current Standing Doctrine*, 71 B.U. L. REV. 667 (1991); Stu Stuller, Note, Lujan v. National Wildlife Federation, 62 U. COLO. L. REV. 933 (1991)(current standing doctrine requires environmental litigants to meet same standing requirements as other public interest litigants).

114. *See, e.g.*, Valley Forge Christian College v. Americans United for Separation of Church and State, Inc., 454 U.S. 464, 471 (1982). The party seeking review in federal court bears the burden of demonstrating standing elements. *See* FW/PBS, Inc. v. Dallas, 493 U.S. 215, 231 (1990); Warth v. Seldin, 422 U.S. 490, 508 (1975).

115. *See* Lujan v. Defenders of Wildlife, 112 S. Ct. 2130 (1992)(environmental group plaintiffs failed to establish that any of their members would be directly injured by federal funding of projects in other countries adverse to endangered species); Lujan v. National Wildlife Fed'n, 497 U.S. 871 (1990) (environmental group which challenged Bureau of Land Management land withdrawal program did not aver sufficient injury in fact to support standing under the APA where plaintiffs merely used lands in vicinity of mining activities).

116. Defenders of Wildlife, 112 S. Ct. at 2136.

117. Whitmore v. Arkansas, 495 U.S. 149, 155 (1990)(citing Los Angeles v. Lyons, 461 U.S. 95 (1983)).

118. Glover River Org. v. United States Dep't of Interior, 675 F.2d 251, 254 (10th Cir. 1982)(citing O'Shea v. Littleton, 414 U.S. 488, 494 (1974)).

The party seeking judicial relief must demonstrate a definite and recognizable injury to itself[119] to satisfy the injury in fact element of standing. Accordingly, the injury must affect the individual in a personal and particularized way.[120] Second, the injury must have a causal connection to the action challenged in the lawsuit.[121] Stated another way, the claimed injury must result from the defendant's actions, and not the result of "the independent action of some third party not before the court."[122] Third, redressability is the relation of the injury to the court's remedial and equitable powers. It must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.[123] The plaintiff's requested relief must remedy the claimed injury.

When a party challenges government action or inaction in federal court, standing depends on whether the plaintiff is the object of the asserted action or inaction.[124] When the plaintiff is the direct object of the government action or inaction, both the causation and redressability elements of standing are usually satisfied.[125] However, when a party's claimed injury arises from the government's regulation or alleged unlawful regulation of another party, the causation and redressability elements of standing are more attenuated.[126] Challenging government action or inaction regarding a third party is therefore substantially more difficult to establish.[127]

### B. *Tenth Circuit Opinions*

In two cases arising from an exchange of federal coal for a conservation easement in Grand Teton National Park, Wyoming, the Tenth Circuit ruled both the State of Wyoming and the Ash Creek Mining Company lacked standing to challenge the Secretary of the Department of the Interior's (Secretary) action. In both *State ex rel. Sullivan*[128] and *Ash Creek Mining Co.*,[129] the State of Wyoming (State) and Ash Creek Mining Company (Ash Creek) appealed the district court's ruling that the parties lacked standing to object to the Secretary's completed exchange of federally owned coal for the JY Ranch conservation easement.

Laurance S. Rockefeller owned the JY Ranch located within Grand Teton National Park, Wyoming. In 1985, Rockefeller negotiated with the Department of the Interior for the exchange of a conservation easement of 1106.49 acres within the ranch for 2560 acres of federally

119. *Id.* at 254.
120. Defenders of Wildlife, 112 S. Ct. at 2136 n.1.
121. Simon v. Eastern Kentucky Welfare Rights Org., 426 U.S. 26, 41-42 (1976).
122. *Id.*
123. *Id.* at 38, 43.
124. Defenders of Wildlife, 112 S. Ct. at 2137.
125. *Id.*
126. *Id.*
127. *Id.* (citing Allen v. Wright, 468 U.S. 737, 758 (1984); Simon v. Eastern Kentucky Welfare Rights Org., 426 U.S. 26, 44-45 (1976); Warth v. Seldin, 422 U.S. 490, 505 (1975)).
128. 969 F.2d 877 (10th Cir. 1992).
129. 969 F.2d 868 (10th Cir. 1992).

owned coal in Sheridan County, Wyoming.[130] In 1987, Rockefeller donated the conservation easement to a non-profit organization, the Sloan-Kettering Institute for Cancer Research (Institute).[131] The Bureau of Land Management (BLM) prepared an environmental assessment of the proposed exchange and concluded an environmental impact statement was unnecessary. Subsequently, the BLM published a notice in the Federal Register detailing the proposed exchange.[132] The State and Ash Creek filed protests to the exchange.[133] Ash Creek, a coal company owned by Public Service Company of Oklahoma, owned a 160-acre fee coal tract adjacent to portions of the Sheridan County coal offered in exchange and was the surface owner of roughly seventy acres overlying the federally owned coal.[134]

On May 11, 1990, the day after the Institute conveyed the conservation easement to the United States, the Department of the Interior dismissed the complaints filed by the State and Ash Creek.[135] The BLM then issued a patent to the Sheridan County coal to the Institute, which subsequently sold the rights to Reserve Coal Properties Company.[136]

Two months later, the State filed a four-count complaint in federal district court against the Secretary, the Department of Interior, Rockefeller, the Institute and Reserve Coal Properties Company.[137] The complaint sought judicial review of the Secretary's action and challenged its validity based on the Federal Land Policy Management Act (FLPMA)[138] and the Secretary's failure to act in the public interest, failure to ensure the parity of the value of the exchanged parcels and failure to follow BLM internal procedure. The final count challenged the Secretary's exchange under the National Environmental Policy Act (NEPA)[139] on the grounds of an inadequate environmental assessment and lack of environmental impact statement.[140] The State alleged the Secretary deprived the State of revenues because the exchange removed coal from the competitive leasing system, under which the Mineral Leasing Act (MLA)[141] entitles the state to recover royalty payments.[142]

On August 21, 1990, Ash Creek filed a complaint in federal district court against the same five parties seeking judicial review of the Secretary's action and requesting invalidation of the exchange.[143] The impetus of Ash Creek's complaint was an interest in acquiring the exchanged

130. *Id.* at 870; *Sullivan*, 969 F.2d at 879.
131. *Sullivan*, 969 F.2d at 879.
132. *Id.*
133. *Id.*; *Ash Creek*, 969 F.2d at 871.
134. *Ash Creek*, 969 F.2d at 871.
135. *Id.*
136. *Id.*
137. *Sullivan*, 969 F.2d at 879.
138. 43 U.S.C. §§ 1701-1784 (1988 & Supp. II 1991).
139. 42 U.S.C. §§ 4321-4370(c) (1988 & Supp. II 1991).
140. *Sullivan*, 969 F.2d at 879-80.
141. 30 U.S.C. §§ 181-287 (1988 & Supp. II 1991).
142. *Sullivan*, 969 F.2d at 880.
143. *Ash Creek*, 969 F.2d at 871.

federal coal through the competitive leasing process.[144] The Ash Creek complaint challenged the Secretary's action under FLPMA, NEPA, MLA and the Administrative Procedure Act (APA)[145].

All defendants successfully moved to dismiss both the State's and Ash Creek's complaint under Rule 12(b)(6) of the Federal Rules of Civil Procedure.[146] The district court noted in both cases that the State and Ash Creek lacked standing to challenge the exchange because the alleged injuries could not be redressed by any conceivable court remedy.[147] Rather, both claimants requested judicial reversal of the Secretary's exchange to dispose of the Sheridan County coal through the competitive leasing system. Ash Creek wished to acquire the coal[148] and the State of Wyoming desired the accompanying royalty revenues.[149] However, the district court noted that the Secretary has discretion with regard to decisions to dispose of the coal through the competitive leasing system. The possibility Ash Creek would acquire the coal was indefinite,[150] as was the potential of the lease producing royalty revenues for the State.[151] The lower court further noted that the State lacked standing under the NEPA claim because the State was not within the zone of interest protected by the statute.[152]

On appeal to the Tenth Circuit, Circuit Judge Ruggero J. Aldisert[153] wrote two nearly identical opinions affirming the district court and dismissing the State and Ash Creek on standing grounds. After deftly summarizing current standing doctrine,[154] Judge Aldisert criticized both parties for failing to present injuries redressable by judicial remedy.

Although the State asserted a colorable injury in fact regarding the deprivation of royalty revenues, the court stated the "case is a conjecture based on speculation that is bottomed on surmise. It ostensibly asserts public policy concerns, but on final analysis, the State's interest begins and ends with the royalties it expected to receive had the Secretary chosen to offer the coal for competitive leasing."[155] In an incredulous tone, Judge Aldisert worked through the logic of the State's

144. *Id.*

145. 5 U.S.C. §§ 500-590 (1988 & Supp. III 1991).

146. *Ash Creek*, 969 F.2d at 872.; *Sullivan*, 969 F.2d at 880. Rule 12(b)(6) states:

> (b) How Presented. Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: . . . (6) failure to state a claim upon which relief can be granted.

FED. R. CIV. P. 12(b)(6).

147. *Ash Creek*, 969 F.2d at 872; *Sullivan*, 969 F.2d at 880.

148. *Ash Creek*, 969 F.2d at 871-72.

149. *Sullivan*, 969 F.2d at 880.

150. *Ash Creek*, 969 F.2d at 872.

151. *Sullivan*, 969 F.2d at 880.

152. *Id.*

153. Ruggero J. Aldisert, Senior Judge, United States Court of Appeals for the Third Circuit, sitting by designation. *Id.* at 878.

154. *Ash Creek*, 969 F.2d at 874-75; *Sullivan*, 969 F.2d at 880-81.

155. *Sullivan*, 969 F.2d at 882.

argument, pausing to express disbelief at the sheer impossibility of a ruling favorable to the State that would redress the asserted injury of lost royalty revenues: "A favorable ruling in this case will not guarantee the State one nickel of coal leasing royalties from these lands."[156] The court pointed out the federal judiciary is powerless to order the Secretary to release federally owned coal through competitive leasing.[157] The court also dismissed the State's FLPMA claim regarding the Secretary's alleged failure to adequately consider the interests of state and local people on the grounds the State's complaint fell outside the zone of interests protected by FLPMA.[158]

Ash Creek fared no better. The court initially criticized the "vagueness and lack of focus in Ash Creek's opening brief"[159] and then analyzed Ash Creek's standing based on two injuries allegedly caused by the exchange: Ash Creek's lost opportunity to participate in competitive coal leasing; and hinderance of its surface ownership rights to lands overlying the exchanged coal.[160] Judge Aldisert dismissed Ash Creek's first asserted injury on the grounds the loss of the possibility of leasing the coal was an injury not redressable by judicial decision and that Ash Creek thereby lacked standing.[161] Ash Creek contended mining of the exchanged coal would adversely impact Ash Creek economically. Apparently the company had stockpiled a huge quantity of overburden on lands overlying the federal coal deposits exchanged for the conservation easement. Overburden is the waste product of the strip mining process. In essence, Ash Creek maintained that its surface ownership, adjacent coal mine and use of the tract at issue as a refuse pile for hundreds of thousands of cubic yards of overburden prevented the Secretary from leasing or exchanging the coal to any party besides Ash Creek.[162] In scalding language, the court ruled:

> To state this argument in these simple terms devoid of the obfuscation and confusion set forth in Ash Creek's written and oral arguments is to expose the futility, and fatality, of the argument. Ash Creek has not demonstrated a substantial nexus between the relief requested and the elimination of its injuries. No court can fashion an order redressing these alleged injuries because no court has the power to vest Ash Creek with mining rights to the exchanged coal lands or to prevent any other coal operator from possessing them.[163]

Accordingly, the Tenth Circuit affirmed the district court and held Ash Creek lacked standing to challenge the exchange of the coal for the conservation easement.[164]

156. *Id.*
157. *Id.*
158. *Id.* at 882-83.
159. *Ash Creek*, 969 F.2d at 873.
160. *Id.* at 873-74.
161. *Id.* at 874.
162. *Id.* at 876.
163. *Id.*
164. *Id.*

C. *Analysis*

After *Ash Creek* and *Sullivan*, parties claiming an injury from proposed or completed public lands exchanges must demonstrate with specificity all three elements of standing or risk denial of federal jurisdiction. As parties indirectly affected by the exchange of the coal for the conservation easement, Ash Creek and the State demonstrated Judge Scalia's maxim set forth in *Lujan v. Defenders of Wildlife*: "[W]hen the plaintiff is not himself the object of the government action or inaction he challenges, standing is not precluded, but is ordinarily 'substantially more difficult' to establish."[165] *Ash Creek* and *Sullivan* demonstrate that "substantially more difficult" should read "nearly impossible."

Although both the State and Ash Creek were so aggrieved by the Secretary's action to pursue litigation in federal court, their injuries were ultimately peripheral to the challenged exchange. The Tenth Circuit focused almost exclusively on the consequences of a ruling favorable to the plaintiffs and held the attenuated chain of causation between the coal exchange and the claimant's alleged injuries prevented their direct and sure redressability.[166]

When establishing standing to invoke federal jurisdiction, parties must draft pleadings and frame the requested relief with care. An actual or perceived injury that may be relieved in some way, even favorably, by judicial remedy may not support standing.[167] Although court action may plausibly alleviate an aggrieved and injured party, the substance of standing supporting federal jurisdiction may dissolve for lack of causation or redressability. Rather, the alleged injury must be both directly caused by the defendant's action or inaction and capable of definite redress through court action. When causation of the injury in fact is traceable directly to the challenged action or inaction, in a singular and demonstrable cause and effect relationship, adequate redressability may exist. However, an injury in fact arising from a multilinked chain of cause and effect is nearly per se invalid to support federal jurisdiction. Causation and redressability are obverse aspects of injury in fact. Injury implies causation, which in turn bears on remedial benefit. Obviously, a judicial remedy directed to actions that have not caused the injury at issue can in no way alleviate that injury.[168]

## CONCLUSION

In *Doheny*, the Tenth Circuit ruled balancing in-kind is the preferred remedy for production imbalances. The opinion comports with case law from other jurisdictions and factors a doctrine into oil and gas law that encourages parties to deliver gas to the marketplace. In *Cheyenne-Arapaho Tribes*, the Tenth Circuit recognized that the Secretary of the Interior

165. Lujan v. Defenders of Wildlife, 112 S. Ct. 2130, 2137 (1992)(quoting Allen v. Wright, 468 U.S. 737, 758 (1984)).

166. *Sullivan*, 969 F.2d at 882; *Ash Creek*, 969 F.2d at 876.

167. Simon v. Eastern Kentucky Welfare Rights Org., 426 U.S. 26, 38, 43 (1976).

168. WRIGHT ET AL., *supra* note 114, § 3531.4.

must act as a fiduciary to Indians regarding mineral leasing on tribal lands held in trust. The government may satisfy its fiduciary obligations, however, by constructing a contemporaneous record that merely considers the Indians' economic best interest. Finally, as demonstrated in *Ash Creek Mining Co.* and *State ex rel. Sullivan*, the Tenth Circuit does not hesitate to invoke standing doctrine to deny federal jurisdiction to challengers indirectly harmed by Department of Interior public lands exchanges.

*Ezekiel J. Williams*

# SECURITIES LAW SURVEY

## I. OVERVIEW

Caveat brokers, registered representatives, accountants, attorneys and others: investors are not taking their lumps. The investors of today refuse to merely accept the failure or poor performance of their investments. Rather, many sue the deepest pocket and recover handsomely for it.[1] Investors sue broker-dealers for breach of trust and confidence; brokerage houses for respondeat superior or controlling person liability and inadequate supervision; other individuals, including accountants and attorneys, for aiding and abetting; and everyone and anyone for securities fraud. The dramatic increase in the number and magnitude of law suits[2] raises concerns that untempered liability for brokers, registered representatives, accountants and attorneys will have far reaching negative effects on capital markets.[3] Concern over the implications to

1. In 1991, the average claim against accounting firms was for $85 million and the average settlement was for $2.7 million. *Big Six Call for Reforms to Slash Litigation Costs*, 24 Sec. Reg. & Law Rep. (BNA) 36, 1460 (Sept. 4, 1992) [hereinafter *Big Six*]. In 1992, the accounting firm of Coopers & Lybrand agreed to pay $50 million to settle the Texas Miniscribe case. *Company News: A $128.1 million Settlement Reached in Miniscribe Case*, N. Y. TIMES, June 4, 1992, at D5.

2. According to Rep. W. J. Tauzin, (D-LA), 1990 and 1991 witnessed a large jump in the number of securities class action lawsuits filed, with 614 suits filed in all—more than the combined total of the previous five years put together. *Big Six CPA Firms Join Battle Against Deep Pocket Lawsuits; Bills Reduce Liability*, 2 THOMSON'S INT'L BANK ACCOUNTANT, 33, 1 (Sept. 7, 1992). According to a position paper from the Big Six accounting firms (Arthur Andersen, Deloitte & Touche, Coopers & Lybrand, Ernst & Young, KPMG Peat Marwick and Price Waterhouse) the accounting profession as a whole faces about 4,000 lawsuits and $30 billion in claims. *Liability System Threatens Independent Audits; U.S. Capital Markets and Global Competitiveness at Risk; Tort Reform Needed Now*, PR Newswire, N. Y., August 31, 1992, *available in* LEXIS, Nexis library (Fin. News) [hereinafter *Liability System*]. In 1991 the Big Six's total expenditures for settling claims was $477 million, an 18% increase over 1990 which were $404 million. *Id.* A survey by the American Institute of Certified Public Accountants ("AICPA") indicates that claims against firms other than the Big Six rose by two-thirds between 1987 and 1991. *Id.*

3. *See Liability System*, *supra* note 2, at *2. Speculators and their attorneys have utilized the securities laws to coerce nuisance settlements. *Id.* Where a company has had volatile stock price fluctuations, namely mid-sized, high-technology high-growth companies new to the market, speculators file class action securities fraud suits with the sole purpose of coercing settlements. *Id.* To increase the size and prospect of settlement, speculators join accountants and other deep pockets who bear joint and several liability, even where their participation was minimal. *Id.* Under the law the company as the defendant bears the burden for the legal costs of discovery. *Id.* Thus, threats of huge legal fees, tarnished corporate image, and joint and several liability induce companies to settle these nuisance suits despite their innocence. *Id.*

In the aftermath of the failure of the accounting firm of Laventhol & Horwath in 1990, the largest bankruptcy for a professional corporation in U.S. history, accounting firms practice risk reduction. *Big Six*, *supra* note 1. Firms avoid what they perceive as high risk audit clients and industries, including financial institutions, insurance companies, real estate investment firms, high-technology firms and private companies making initial public offerings. *Id.* As a result, three hundred corporate, accounting, financial institution and association members including the Big Six accounting firms, the AICPA, Merrill Lynch & Co., Morgan Stanley & Co., Inc., the National Association of Corporate Directors, the Public Securities Association and the Securities Industry Association have joined together

American business of private securities litigation has prompted members of Congress in both houses to introduce legislation[4] aimed at curbing implied private securities fraud suits under Rule 10b-5.[5]

The U.S. Court of Appeals for the Tenth Circuit has not been immune from these concerns or trends. During the recent survey period the circuit decided three cases involving brokers' and accountants' liability. In all of them, the court refused to attach liability to the brokers or accountants. The court's language in these decisions suggests a judicial attitude reflecting curtailment of, or at least a refusal to expand, the scope of Rule 10b-5 liability. In *Board of County Commissioners of San Juan County v. Liberty Group*,[6] the court reversed the trial court's imposition of liability against a broker for churning based on simple negligence. In *O'Connor v. R.F. Lafferty & Co., Inc.*,[7] the court upheld a grant of summary judgment in favor of the broker, determining that the investor failed to establish the requisite scienter for an unsuitability claim under Rule 10b-5. In curtailing Rule 10b-5 liability, the court imposed an additional requirement of control to establish an unsuitability claim. Finally, in *Farlow v. Peat, Marwick, Mitchell & Co.*,[8] the court dismissed securities fraud claims against an accounting firm for failure to allege fraud with particularity and upheld a summary judgment ruling in favor of the accounting firm on aiding and abetting claims.

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in the Coalition to Eliminate Abusive Securities Suits ("CEASS") to launch a coordinated federal and state effort to achieve liability reform. *Securities Suits Reform Bill Lauded by Business Coalition*, PR Newswire, N. Y., August 13, 1992, *available in* LEXIS, Nexis Library (Fin. News). According to Philip B. Chenok, president of the AICPA, "The current doctrine of joint and several liability must be replaced if accountants are to continue performing audits in high-risk situations such as initial public offerings." *Id.* Chenok pointed out that a competent outside audit is a requirement for any company seeking to raise capital in the stock or bond markets. *Id.*

4. S. 3181, 102d Cong., 2d Sess. (1992) in the Senate Banking Committee and H.R. 5828, 102d Cong., 2d Sess. (1992) in the House Energy and Commerce Committee were introduced to reduce frivolous securities fraud suits filed to coerce nuisance settlements. To achieve this both bills carry provisions restricting the application of the joint and several liability standard and limiting an actor's liability only to damages that result directly from the actor's work. In addition, both bills provide judicial discretion that can require unsuccessful plaintiffs to shoulder all legal costs. Thus, the bills reduce the coercive tools available to speculators by altering joint and several liability to proportionate liability. The bills also prescribe a disincentive for filing meritless claims. Voting on these bills is scheduled to occur early in 1993.

5. "Rule 10b-5" is the implied right of action for fraud in the purchase or sale of securities found in Rule 10b-5 promulgated under the Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b). Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1992).

6. 965 F.2d 879 (10th Cir. 1992).

7. 965 F.2d 893 (10th Cir. 1992).

8. 956 F.2d 982 (10th Cir. 1992).

## II. Recent Tenth Circuit Decisions Show A Reluctance to Expand the Scope of Securities Fraud Liability.

### A. *Rule 10b-5 Liability Not Expanded to Include Acts of Mere Negligence*

In *Board of County Commissioners v. Liberty Group* the Tenth Circuit reversed the trial court's expansion of "scienter" to include acts of negligence. In *Liberty Group*, the County of San Juan, New Mexico ("County") used a number of brokers for its investments. Liberty Group executed thirteen transactions in which it charged mark-ups over the price paid for the bonds, but never informed the County of the charges. After the mark-ups were discovered by the State Auditor, the County brought suit under Rule 10b-5 and the Racketeer Influenced and Corrupt Organizations Act ("RICO").[9] The County claimed that Liberty's registered representative had churned the County's account by making frequent trades and charging excessive and undisclosed mark-ups.[10] The jury charge included Instruction 24, which described the requisite mental state for liability on a Rule 10b-5 churning claim as follows:

> The plaintiff, in order to recover on his 10B-5 claim, must show that the defendant acted knowingly, that is, with a mental state embracing intent to deceive, manipulate, or defraud. In order to establish this element the plaintiff must prove by the greater weight of the evidence that the defendant made material statements which he knew to be false, or made statements with reckless disregard for their truth or falsity, *or knew of the existence of material facts which were not disclosed and he should have realized their significance in the making of an investment decision*, or knew of the existence of material facts which were not disclosed although he knew that knowledge of those facts would be necessary to make his other statements not misleading.[11]

The defendants objected that this instruction incorrectly stated the law, asserting that the instruction allowed liability to be imposed for mere negligence.[12] The court denied the objection and the jury found Liberty liable for churning.[13] Liberty appealed.

Although no cases by the U.S. Supreme Court confirm the existence of a churning cause of action, the lower courts generally agree to its existence and elements.[14] Churning, under Rule 10b-5, developed from the New York Stock Exchange (NYSE) Know Your Customer Rule,[15] the National Association of Security Dealers (NASD) Rules of Fair Practice[16]

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9. 18 U.S.C. §§ 1961-1964 (1990).
10. *Liberty Group*, 965 F.2d at 881.
11. *Id.* at 883.
12. *Id.*
13. *Id.* at 881-82.
14. *See* Mark C. Jensen, *Abuse of Discretion Claims Under Rule 10b-5: Churning, Unsuitability, and Unauthorized Transactions*, 18 Sec. Reg. L.J. 374, 377-78 (1991).
15. The New York Stock Exchange, *Know Your Customer Rule* provides: "Every member organization is required . . . to (1) Use due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization." NYSE Rule 405, CCH New York Stock Exchange Manual ¶ 2405 (1990).
16. National Association of Securities Dealers, *Rules of Fair Practice*, Art. III, sec. 2(a) ¶ 2152 (1991):

and the Securities and Exchange Rule 15c1-7(a).[17] In the Tenth Circuit, the elements of a churning claim include: (1) excessive trading in light of the plaintiff's investment objectives; (2) control over the trading in the account; and (3) scienter.[18]

The excessive trading element, unique in each churning case, depends upon the investor's objectives and the communication of those objectives to the broker. As a question of fact, excessive trading has been found *prima facie* where the annual turnover rate, the dollar value of the investor's transactions with his broker for the entire year divided by the investor's average monthly equity in his account, is greater than six.[19] However, some have criticized this turnover rate test.[20] The Fifth Circuit, for example, in determining "excessive trading" also considered the nature and objectives of the account, the in-and-out trading, the holding period of the respective securities, the broker's profit, the NYSE Know Your Customer Rule and the NASD suitability rules.[21]

The second element, control, occurs where the broker has actual discretionary authority to execute transactions for the investor without prior authorization. Where the broker lacks discretionary authority, control may occur de facto. For instance, where the investor lacks the ability to evaluate recommendations and to exercise his or her own independent judgment, courts consider the broker to possess de facto control.[22] In determining de facto control, some courts focus on the investor's capacity or practical ability to evaluate the broker's recommendations and to reject unsuitable transactions.[23] Other courts consider that as long as the investor has the capacity to exercise his final

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In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other securities holdings and as to his financial situation and need.

17. Rule 15c1-7(a) prohibits excessively large or excessively frequent trading in discretionary accounts. The Rule provides:

> The term *manipulative deceptive or other fraudulent device or contrivance* as used in section 15(c) of the Act, is hereby defined to include any act of any broker, or dealer or municipal securities dealer designed to effect with or for any customer's account in respect to which such broker, dealer or municipal securities dealer his agent or employee is vested with any discretionary power in any transactions of purchase or sale which are excessive in size or frequency in view of the financial resources and character of such account.

C.F.R. § 240.15c1-7(a) (1992).

18. *See, e.g.*, Lafferty, 965 F.2d at 893; Adams v. Merrill Lynch, Pierce, Fenner & Smith, 888 F.2d 696 (10th Cir. 1989); Hotmar v. Lowell H. Listrom & Co., 808 F.2d 1384 (10th Cir. 1987).

19. Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980).

20. *See, e.g.*, Norman S. Poser, *Options Account Fraud: Securities Churning in a New Context*, 39 BUS. LAW. 571, 596-98 (1984) (criticizing the turnover rate as a measure of excessive trading because it ignores other factors).

21. Miley v. Oppenheimer & Co., Inc., 637 F.2d 318 (5th Cir. 1981). *See also Know Your Customer Rule*, NYSE Rule 405, CCH New York Stock Exchange Manual ¶ 2405 (1990); National Association of Securities Dealers, *Rules of Fair Practice*, Art. III, sec. 2, ¶ 2152 (1991).

22. Follansbee v. Davis, Skaggs & Co., 681 F.2d 673, 676-77 (9th Cir. 1982).

23. *Id.*

right to say "yes" or "no," the investor controls the account.[24]

In *Liberty Group*, the Tenth Circuit did not delve into an analysis of the excessive trading or control elements for churning. Rather, the court determined the case on the issue of the final element, the requisite mental state of scienter,[25] and particularly the defendant's assertion that Rule 10b-5 liability required more than mere negligence.[26] Scienter, common to all Rule 10b-5 claims, exists in a churning claim when a broker acted with actual intent to defraud or with a reckless disregard of the investor's interests.[27]

In *Ernst & Ernst v. Hochfelder*,[28] the United States Supreme Court established that 10b-5 liability required scienter, but expressly declined to decide whether scienter included "recklessness."[29] Six years after *Hochfelder*, the Tenth Circuit joined an emerging trend[30] deciding this question in the affirmative.[31] The court stated that reckless behavior includes "an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or so obvious that the actor must have been aware of it."[32] As a result of this and other decisions, Rule 10b-5 liability had expanded to include reckless behavior.

In *Liberty Group*, the Tenth Circuit had opportunity to further expand liability to include acts of mere negligence. Liberty, the defendant, recognized that the language "should have realized" in Instruction 24 provided a finding of fault based on that lesser standard. Liberty argued that scienter should not be expanded because *Hochfelder* required "much more than mere negligence."[33] The Tenth Circuit agreed. It held the trial court's instruction on the Rule 10b-5 count, allowing a finding of fault based on the simple negligence standard of "should have realized," to be error as a matter of law.[34] In doing so the Tenth Circuit restricted an expansion of the scope of Rule 10b-5 liability to acts of simple negligence.

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24. Carras v. Burns, 516 F.2d 251, 258 (4th Cir. 1975) (stating investor has control if she has "sufficient financial acumen to determine her own best interests and she acquiesces in the broker's management").

25. *Liberty Group*, 965 F.2d at 883.

26. *Id.*

27. " 'Scienter is a mental state embracing intent to deceive, manipulate, or defraud.' " *Id.* (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)).

28. 425 U.S 185 (1976).

29. *Id.*

30. *See, e.g.*, G.A. Thompson & Co. v. Partridge, 636 F.2d 945, 961-62 (5th Cir. 1981); McLean v. Alexander, 599 F.2d 1190, 1197 (3d Cir. 1979); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1023 (6th Cir. 1979); Nelson v. Serwold, 576 F.2d 1332, 1337 (9th Cir.), *cert. denied*, 439 U.S. 970 (1978); Rolf v. Blyth, Eastman, Dillon & Co., 570 F.2d 38, 44 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1039-40 (7th Cir.), *cert. denied*, 434 U.S. 875 (1977).

31. Hackbart v. Holmes, 675 F.2d 1114, 1117 (10th Cir. 1982) (expressly holding "recklessness satisfies the scienter requirement").

32. *Id.* at 1118.

33. *Liberty Group*, 965 F.2d at 883 (citing *Hochfelder*, 425 U. S. at 193).

34. *Id.* at 882-83.

B. *Primary and Secondary Liability Restricted Under Rule 10b-5.*

1. Primary Liability Restricted for Breach of Trust and Confidence by Imposing the Element of Control

In *O'Connor v. R. F. Lafferty & Co.*, the Tenth Circuit analyzed a claim of unsuitability and added the requirement of control. In 1975, Carol O'Connor received $200,000 from her divorce and deposited the entire sum into an account with the investment firm of R.F. Lafferty & Company, Inc. ("Lafferty"), to be handled by Roy Foulke.[35] She gave Lafferty and Foulke complete discretion to handle her account. Foulke knew that she relied on him to make all decisions concerning the account, that maintaining a savings account was her only prior investment experience and that her objective was to receive a fixed monthly income. When O'Connor became concerned about the value of her account she directed Foulke to stop all trading. Claiming that Foulke and Lafferty purchased securities unsuitable for her investment objective, she brought suit under Section 10(b) of the 1934 Act and Rule 10b-5 alleging liability against Foulke for unsuitability and against Lafferty as controlling person and under the doctrine of respondeat superior.[36] The trial court granted summary judgment, finding that the defendants lacked the requisite scienter to sustain such a claim.[37] The court also found that although the defendants had invested in unsuitable securities, O'Connor could not demonstrate justifiable reliance on the purchases where she knew that the securities were unsuitable and, acting recklessly, failed to investigate.[38] O'Connor appealed.[39]

In affirming the summary judgment order, the Tenth Circuit, in its analysis of the unsuitability claim, recognized that although the elements for churning were well established, the elements for unsuitability were not. As with churning, unsuitability claims are premised on the NYSE Know Your Customer Rule and the NASD Rules of Fair Practice.[40] Courts analyze unsuitability as either a claim based on material omissions or misrepresentations, or as a claim based on fraudulent practices.[41] Unsuitability claims based on material omission or misrepresentation are widely accepted, amounting to little more than specialized versions of ordinary omission or misrepresentation claims.[42]

35. *Lafferty*, 965 F.2d at 895.
36. *Id.* at 896.
37. *Id.* at 893.
38. *Id.*
39. *Id.*
40. *See supra* note 15-16.
41. *See* San Jose v. Paine, Webber, Jackson & Curtis, Inc., No. C 84-20601 RFP, 1991 U.S. Dist. LEXIS 8318, (N.D. Cal. June 6, 1991).
42. *Id.* at *3. "Under this [omission] theory, it would appear that a suitability claim is merely a specialized form of an ordinary omission claim. *Id.*

For cases accepting unsuitability claims based on omission or misrepresentation, see Lefkowitz v. Smith Barney, Harris Upham, Co., 804 F.2d 154, 155 (1st Cir. 1986); Lazzaro v. Manber, 701 F. Supp. 353, 363 (E.D.N.Y. 1988); Arlington Heights Police Pension Fund v. Poder, 700 F. Supp. 405, 406 (N.D. Ill. 1988); Frota v. Prudential-Bache Sec., Inc., [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,253 (S.D.N.Y. 1987); Rush v. Oppenheimer & Co., 592 F. Supp. 1108, 1112 (S.D.N.Y. 1984); M & B Contracting, Corp. v.

An ordinary omission claim occurs when the defendant fails to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading.[43] However, for this failure to disclose to be actionable, the defendant must have had a duty to disclose that information.[44] This duty arises out of relationship of trust and confidence between parties.[45] In the typical securities case, the defendant's duty arises from the fiduciary relationship between the broker and the investor.[46] Thus, an omission or misrepresentation based unsuitability claim arises when the defendant, knowing of plaintiff's investment objectives, recommends a course of trading at odds with those objectives. The broker, in effect, is omitting to tell the investor about the unsuitability of the recommendation.[47] The broker may also be breaching a duty to disclose the nature of the recommended transaction in such a way that the investor could understand its ramifications.[48]

In *Lafferty*, however, Ms. O'Connor did not assert that the registered representative failed to tell her the stocks he purchased were unsuitable. Rather, she claimed that he fraudulently purchased stocks for her account. She asserted unsuitability not on omission or misrepresentation, but on fraud by conduct. Unsuitability claims based on fraudulent practices or fraud by conduct are less settled than omission unsuitably claims and courts tend to mix the concepts of traditional securities fraud and fraud by conduct.[49] Due to these differing approaches, a uniform set of elements has yet to be established, though a consensus seems to be emerging. The Second Circuit, in *Clark v. John Lamula & Co.*,[50] first developed elements for unsuitability not based on misrepresentation or omission. The early cases did not describe the claim or define its ele-

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Dale, 601 F. Supp. 1106 (E.D. Mich. 1984); Mauriber v. Shearson/Am. Express, Inc., 567 F. Supp. 1231, 1237 (S.D.N.Y. 1983).

Procedure in unsuitability cases relates to procedures under traditional securities fraud claims, but the plaintiff's allegations of unsuitability must be sufficiently specific and must be material to an ordinary investor. Craighead v. E.F. Hutton & Co., 899 F.2d 485, 493-94 (6th Cir. 1990); Franks v. Cavanaugh, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,441, 92,845 (S.D.N.Y. 1989). *See also* Osborn v. E.F. Hutton & Co., 853 F.2d 616, 618 (8th Cir. 1988) (upholding claim dismissal where plaintiff failed "to identify any allegedly false representations or a single trade made because of improper advice"); *Lefkowitz*, 804 F.2d at 156 (finding investor's allegations insufficient to establish what objectives were); Bischoff v. G.K. Scott & Co., 687 F. Supp. 746, 750-53 (E.D.N.Y. 1986) (stating alleged investment objectives were insufficiently specific and alleged nondisclosures too vague). *See generally* FED. R. CIV. P. 9(b).

43. 17 C.F.R. § 240.10b-5 (1992).

44. Chiarella v. United States, 445 U.S. 222 (1980).

45. *Id.* at 230.

46. Leason v. Rosart, 811 F.2d 1322 (9th Cir. 1987)(holding brokers have a fiduciary duty to their investors).

47. *Lafferty*, 965 F.2d at 897. *See also San Jose*, 1991 U.S. Dist. LEXIS 8318, at *3.

48. *See, e.g.*, Vucinich v. Paine, Webber, Jackson & Curtis, Inc., 803 F.2d 454, 460 (9th Cir. 1986); Kehr v. Smith Barney, Harris Upham & Co., 736 F.2d 1283, 1286 (9th Cir. 1984).

49. Jensen, *supra* note 14, at 386-87.

50. 583 F.2d 594 (2d Cir. 1978).

ments.[51] Under the *Lamula* test the plaintiff merely had to prove that the broker made a recommendation of unsuitable securities with either intent to defraud or reckless disregard for the investor's interests.[52] Unsuitability could be found where the investor proved that the broker knew or reasonably believed the recommended securities were unsuitable but still recommended purchase to the investor.[53]

The modern view, adopted by the Tenth Circuit, regards unsuitability based on fraud by conduct analogous to, or part of, a churning claim.[54] The courts' analysis of this unsuitability claim supports each of the three elements of churning: (1) unsuitability rather than churning—unreasonable quality of transactions rather than excessive quantity of transactions); (2) scienter;[55] and (3) control.[56] The same requirements that establish control in churning claims also define control in unsuitability claims, i.e., control exists through actual discretionary authority on the part of the registered representative, or de facto discretionary authority due to the investor's inability to evaluate recommendations or to exercise independent judgment.[57] Virtually every case that allows fraud by conduct-unsuitability claims to proceed involve allegations of control. However, these unsuitability claims are often combined with or made part of churning claims, which necessarily require control. When both claims are asserted courts do not articulate whether the unsuitability analysis includes a separate element of control. This oversight clouds the description and requirements of the claim for fraud by conduct-unsuitability. In a fraud by conduct claim the defendant has made no overt representation. However, as with any other claim based on si-

51. *See* Hecht v. Harris Upham & Co., 430 F.2d 1202, 1209 (9th Cir. 1970); Mihara v. Dean Witter & Co., 619 F.2d 814 (9th Cir. 1980).

52. *Id.* at 600. As with the misrepresentation-based claim, the fraud by conduct claim also requires the investors' allegations regarding their objectives and resources to be sufficiently specific and material. This specificity with which the investor's objectives and resources are communicated and known by the broker must be alleged and proven. *See, e.g., Craighead*, 889 F.2d at 490-91 (holding complaint must plead specific facts constituting excessive trading); Penson v. Cowen & Co., [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,868 (S.D.N.Y. 1990) (dismissing complaint for failing to allege with particularity specific instructions to broker).

53. *Lamula*, 583 F.2d at 600.

54. The First Circuit described an unsuitability claim as going to the quality of the securities compared with churning going to the quantity. Tiernan v. Blyth, Eastman, Dillon & Co., 719 F.2d 1, 4-5 (1st Cir. 1983). *Accord* Lopez v. Dean Witter Reynolds, Inc., [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,881 (N.D. Cal. 1984). The Tenth Circuit here held that "[f]raud by conduct is a violation of Rule 10b-5(a) and (c) and is analogous to a churning claim." *R.F. Lafferty*, 965 F.2d at 898.

55. As with other Rule 10b-5 claims, unsuitability requires scienter. Scienter in unsuitability cases has been described as the intent to defraud the investor or the reckless disregard of the investor's interests. *See, e.g.*, Miley v. Oppenheimer & Co., 637 F.2d 318, 324 (5th Cir. 1981).

56. Some courts have explicitly required control in unsuitability claims. Wieringa v. Oppenheimer & Co., [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,986, 90,906 (N.D. Ohio 1985). *See also Craighead*, 899 F.2d at 493-94 (affirming dismissal of unsuitability claim where control was not alleged). While other courts have allowed implied control. Yet, some degree of control is required. *See, e.g., Rolf*, 637 F.2d at 80-81 (no liability for executing orders for unsuitable securities). *Accord* Stander v. Financial Clearing & Serv. Corp., 730 F. Supp. 1282 (S.D.N.Y. 1990).

57. *See supra* notes 22-24 and accompanying text.

lence, liability only occurs under Rule 10b-5 when there is a duty to disclose between broker or agent and client.[58] Showing control establishes a registered representative's duty to his investor because an agent generally has the duty not to misuse the principal's property placed in his control.[59] If control is not required, an alternative duty must be established to ensure the unsuitability doctrine satisfies rule 10b-5.[60]

In *Lafferty* the Tenth Circuit recognized that other circuits required a plaintiff to merely prove unsuitability and scienter to succeed on their claim for unsuitability based on fraud by conduct. The Tenth Circuit imposed the additional element of control. Accordingly a plaintiff must prove three elements to maintain a fraud by conduct unsuitability claim: (1) that the registered representative recommended—or in the case of a discretionary account purchased—securities which are unsuitable in light of the investor's objectives; (2) that the broker recommended or purchased the securities with intent to defraud or with reckless disregard for the investor's interests; and, (3) that the broker exercised control over the investor's account.[61] Here the court determined that although the defendants had invested in unsuitable securities, the plaintiff failed to establish the requisite scienter, since the conduct failed to rise to the level of recklessness necessary to sustain a 10b-5 claim.[62] Accordingly, the court upheld summary judgment dismissing the unsuitability claim, remanding only the state law negligence claims.[63]

The facts in *Lafferty* allowed the court to analyze and decide the case on the issue of scienter alone. Yet, the court went further and imposed the additional requirement of control for fraud by conduct-unsuitability claims, choosing to follow the trend to restrict the scope of Rule 10b-5 liability. This aggressive opinion illustrates the Circuit's reluctance to follow other jurisdictions, which have extended the cause of action for unsuitability. For example, in 1991, unsuitability claims were expanded to include discount brokers who typically take orders, have no discretionary authority, and make no recommendations. An arbitration panel of the National Association of Securities Dealers ("NASD") awarded a Florida investor $39,500 of the $132,000 he claimed to have lost trading options with the brokerage firm of Charles Schwab & Co., Inc.[64] The panel premised its decision on suitability violations. Two of the three arbitrators ruled that Schwab had neglected its "ongoing obligation" to monitor the suitability of its client's investments, strategy and trading decisions.[65] The third arbitrator found Schwab's actions appropriate under the circumstances because the broker appeared to assume an obligation to determine suitability.[66] Under either rationale the award ex-

58. *Chiarella*, 445 U.S. at 235.
59. RESTATEMENT (SECOND) OF AGENCY § 402 (1977).
60. *Chiarella*, 445 U.S. at 222.
61. *Lafferty*, 965 F.2d at 898.
62. *Id.* at 898-900.
63. *Id.* at 900.
64. Peterzell v. Charles Schwab & Co., Inc., NASD, No. 88-02868, June 17, 1991.
65. *Id.*
66. *Id.*

panded unsuitability liability to brokers who neither make recommendations nor have any discretionary authority.[67]

Other courts have expanded broker liability by holding that a violation of the suitability rules support state law claims for fraud.[68] This increases liability by including "negligence" as the requisite mental state sufficient for some state claims.[69] Still other courts have extended liability by providing a private right of action for violations of the NYSE and NASD suitability rules.[70] The majority of modern courts, however, refuse to premise a private right of action upon a violation of an exchange rule.[71] Indeed, the *Lafferty* court refused to decide whether a violation of the NYSE or NASD Rules gave rise to a private cause of action based on negligence, reasoning that actions violating the unsuitability rules give rise to Rule 10b-5 claims.[72] Since Rule 10b-5 violations require proof of scienter,[73] the court refused, as in *Liberty Group*, to extend liability to include acts of mere negligence.[74]

### 2. Primary Liability Restricted for Failure to Reasonably Supervise

#### a. *Liability of the Brokerage Firm*

In most cases where a substantial investment amount has been lost, the investor seeks redress not only from the registered representative but also from the brokerage firm and/or supervisors. Investors sue such defendants for inadequate employee supervision of their fraudulent salesman. In *Lafferty*, Ms. O'Connor brought suit against R.F. Lafferty & Company for negligent failure to supervise the conduct of its registered representative, Mr. Foulke.[75]

The New York Stock Exchange and the Self Regulating Organizations (SRO) all require brokerage firms to reasonably supervise their

67. The Schwab decision followed a 1990 arbitration ruling that discount broker Quick & Reilly pay an investor $106,653 for allowing him to trade in naked put options. Quick & Reilly, Inc. and Q & R Clearing Corp. v. Barton, NYSE, No. 9002033, February 15, 1990. Like Schwab, Quick & Reilly had made no specific investment recommendations to its client, nor retained any discretionary authority. *Id.*

68. *See, e.g.*, Mihara v. Dean Witter & Co., Inc., 619 F.2d 814 (9th Cir. 1980); Twomey v. Mitchum, Jones & Templeton, Inc., 69 Cal. Rptr. 222, 243 (1968).

69. *See, e.g.*, *Lafferty*, 965 F.2d at 900 ("liability under the state analogue to § 12(2) only requires negligence"). *See* COLO. REV. STAT. § 11-51-125(3) (1987). *See also* Pottern v. Bache Halsey Stuart, Inc., 589 P.2d 1378, 1379 (1978) (ruling state analogue to federal Section 12(2) requires only negligence).

70. Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, 410 F.2d 135, 143 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969); Rolf v. Blyth Eastman Dillon & Co., 424 F. Supp. 1021, 1040-43 (S.D.N.Y. 1977), *modified on other grounds*, 570 F.2d 38 (2d Cir. 1978).

71. *See, e.g.*, SSH Co. Ltd. v. Shearson Lehman Bros., 678 F. Supp. 1055, 1058 (S.D.N.Y. 1987).

72. *Lafferty*, 965 F.2d at 897 n.5. "Federal courts recognize such a claim [unsuitability] as a violation of § 10(b) and Rule 10b-5." *Id.* at 897.

73. *See supra* notes 25-26 and accompanying text.

74. *Liberty Group*, 965 F.2d at 883. "[T]he appellants . . . [argue] . . . that Ernst & Ernst v. Hochfelder . . . established that 10b-5 liability requires much more than mere negligence. This reading is correct." *Id.*

75. *Lafferty*, 965 F.2d at 903.

registered representatives and establish systems to prevent these agents from violating the securities laws and the rules and regulations of the SROs.[76] A firm may be civilly liable or face regulatory sanctions for fail-

76. Section 15(b)(4)(E) of the Securities Exchange Act of 1934 provides sanctions against a broker-dealer found to have:

> failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this subparagraph (E) no person shall be deemed to have failed reasonably to supervise any other person, if - (i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and (ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

Section 15(f) of the Exchange Act requires broker-dealers to "establish, maintain and enforce written policies and procedures reasonably designed . . . to prevent the misuse . . . of material nonpublic information by such broker or dealer or any person associated with such broker or dealer."

Section 21A of the Exchange Act provides civil penalties against controlling persons who "knowingly or recklessly" fail to establish, maintain or enforce any policy or procedure required under Section 15(f).

NASD Rules of Fair Practice, Article III, section 27 requires members to establish, maintain and enforce written procedures for supervising activities of registered representatives, reviewing customer accounts, and keeping records. Section 27 further requires that members: (1) designate a registered principal for each type of the firm's business to carry out the firm's supervisory obligations; (2) designate an office of supervisory jurisdiction for each location; (3) assign registered persons to a supervisor; (4) make reasonable efforts to ensure that the supervisory personnel are properly qualified; (5) designate a principal to review the firm's supervisory practices and procedures and make recommendations to senior management to assure compliance with the applicable rules and regulations; (6) establish a schedule of branch examinations; and (7) meet at least annually with each registered representative to discuss compliance matters relevant to the representative. The NASD has also recently required members to use their best efforts to obtain the most recent Form U-5 for any person seeking employment in the capacity of a registered representative and to conduct a thorough background search on all prospective account executives.

NYSE Rule 405(2) requires member organizations to "[s]upervise diligently all accounts handled by registered representatives of the organization."

NYSE Rule 342 requires the person in charge of a group of employees to "reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer and compliance with securities laws and regulations." The firm must also designate a senior person to have "overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations." This person must then:

> delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control [and] establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.

NYSE Rule 342 also requires member firms to review proprietary trades of the firm and trades of firm employees and family members for insider trading violations and other manipulative and deceptive practices. It also requires that the firm prepare an annual report to its chief executive officers, which discusses, among other matters, customer complaints, internal investigations made during the year, significant compliance problems, and compliance efforts and procedures.

NYSE Rule 351 requires that member firms submit quarterly written reports to the NYSE signed by a senior officer of the firm stating that the firm has reviewed its proprietary accounts and accounts of its employees and family members and that trades in those accounts do not violate the Exchange Act or NYSE rules against insider trading and manipulative and deceptive devices. The firms may use sampling techniques to review pro-

ing to reasonably supervise a registered representative who violates a securities law or rule.[77] However, the brokerage firm may avoid liability and sanctions by acting in good faith to fulfill its obligations. Good faith may be established by showing the adequacy of a firm's supervision and compliance systems.[78] There is probably no single supervisory or compliance system appropriate for all brokerage firms. Thus, the rules of the Exchange, the various SROs, as well as the SEC, anticipate each brokerage firm will develop its own system to ensure effective compliance with the various laws, rules and regulations based on the nature of its business. The established supervisory system, however, must meet various SRO requirements.[79] A firm's noncompliance with its own policies may result in liability.[80]

In upholding summary judgment in favor of the registered representative, the *Lafferty* court avoided a complex analysis to determine whether Lafferty inadequately supervised Foulke. The court held instead that no claim for inadequate supervision may be maintained against the brokerage firm without an underlying violation of a securities law or rule by the registered representative.[81] Thus, in restricting the registered representative's liability by imposing a control requirement, the Tenth Circuit has, in effect, restricted the scope of liability faced by the representative's brokerage firm.

b. *Compliance Department Personnel and Other Supervisors' Exposure*

The trend to restrict the scope of untempered exposure for inadequate supervision has been followed by the Securities and Exchange Commission (SEC). Had the registered representative in *Lafferty* violated the securities laws, conceivably his superiors may have faced individual sanctions for failure to adequately supervise. In determining exposure for sanctions the SEC has focused on the lack of adequate procedures,[82] the failure to follow such procedures[83] and the personal fail-

prietary accounts and employee accounts, provided that each employee account is reviewed during one of the year's quarters. Rule 351 also requires that members provide the Exchange with statistical information regarding customer complaints relating to matters designated by the Exchange. This provision is yet to be implemented by the Exchange.

77. *See, e.g.*, Securities Exchange Act of 1934, §§ 21A & 15(b)(4)(E).

78. *See, e.g.*, Trustman v. Merrill Lynch, Fenner & Smith, Inc., [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,936 (C.D. Cal. 1985); Smith v. Christie, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,828 (N.D. Cal. 1980).

79. *See, e.g.*, NYSE Rules 342, 351, 405, and 476 and NASD Rules of Fair Practice, art. III, sec. 27, *supra* note 76.

80. Thropp v. Bache Halsey Stuart Shields, Inc., 650 F.2d 817, 820 (6th Cir. 1981) (finding negligence based on defendant's failure to diligently enforce own rules).

81. *See Lafferty*, 965 F.2d at 898-900.

82. *See, e.g.*, Mabon Nugent & Co., Exchange Act Release No. 27301, 1989 SEC LEXIS 1865 (Sept. 27, 1989).

> Effective supervision by broker-dealers is a critical element in the regulatory scheme and its importance has increased as firms have grown in size. As broker-dealers expand their activities through the acquisition of branch offices or into new areas within the securities business, there must be a concomitant expansion of their supervisory procedures to insure regulatory compliance and sound inter-

ure of line and staff supervisors to supervise account executives.[84]

*In re Chambers*,[85] decided by the SEC in April of 1990, indicated that a chief compliance officer responsible for maintaining adequate supervisory and compliance procedures within a brokerage firm could be held personally liable under section 15(b)(4)(E) of the 1934 Act[86] for deficiencies in supervision.[87] The *Chambers* case was settled and therefore offered little insight about the factual or legal basis for the SEC's position or what steps compliance officers should take to avoid exposure. The concerns raised in *Chambers* subsided following the decision of *In re Arthur James Huff*.[88]

In March of 1991, the SEC commenced an enforcement action against Huff, a vice president in the compliance department of

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nal controls. Apart from adopting effective procedures, broker-dealers must provide effective staffing, efficient resources and a system of follow-up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers and other personnel is being diligently exercised.

*Id.* at *2-3.

83. *See, e.g.*, Barlage, Exchange Act Release No. 25563, 1988 SEC LEXIS 740 (April 8, 1988). The SEC found a branch manager liable for failing to supervise a registered representative by not following and enforcing brokerage firm's supervisory policies and procedures, by not enforcing non-solicitation bans, and by not stopping broker's fraudulent solicitations. *Id.* The brokerage firm was also found to have failed to supervise the branch manager. *Id.*

84. *See, e.g.*, Louis R. Trujillo, Exchange Act Release No. 26635, 43 S.E.C. 690 (March 16, 1989). Trujillo, an administrative branch manager of Merrill Lynch, discovered some broker misconduct and reported it to the branch manager, but his supervisory record was "less than exemplary," since a more thorough investigation would have revealed additional misconduct. *Id.* Nevertheless, emphasizing that the statute requires only "reasonable supervision under the attendant circumstances," and the limited scope of Trujillo's authority, the SEC Commissioners held that the SEC staff had failed to prove that "Trujillo's overall performance with respect to the activities of the broker amounted to a failure to supervise." *Id.* The SEC found that Trujillo had made reasonable and diligent efforts to inform the branch manager. *Id.* The SEC also noted the Trujillo had gone over the branch manager's head to place the matter in the hands of higher ranking officials in Merrill Lynch. *Id.* The SEC concluded:

> while we believe that Trujillo could and perhaps should have taken such steps sooner, our standard is that a manager (of any stripe) 'must respond reasonably when confronted with the indication of wrongdoing.' Trujillo's responses as an 'administrative manager' were not unreasonable, and we should not ignore the fact that his actions were a major factor in the broker's dismissal.

*Id.*

85. Exchange Act Release No. 27963, 1990 SEC LEXIS 808 (April 30, 1990).

86. Section 15(b)(4)(E) of the 1934 Act provides:

> The Commission, by order, shall censure, . . . or revoke the registration of any broker or dealer if it finds, . . . that such censure, . . . is in the public interest and that such broker or dealer, . . . has failed reasonably to supervise, with a view to preventing violations of the [securities laws], another person who commits such a violation, if such other person is subject to his supervision.

Securities Exchange Act of 1934, § 15(b)(4)(E)15 U.S.C. § 78*o*(b)(4)(E).

87. *Chambers*, 1990 SEC LEXIS 808 at *2. Pursuant to an offer of settlement, the SEC entered an order against the Compliance Director of a regional firm finding that he failed to adequately supervise two account executives who had churned investor accounts, engaged in unsuitable transactions, and made oral misrepresentations to investors. *Id.* The SEC found that the Director had been given the responsibility to ensure that the firm adopted and enforced adequate supervisory and compliance procedures. *Id.* The firm's Compliance Manual did not clearly vest responsibility in any supervisor, and thus, the SEC found that the Director had failed to fulfill his responsibilities. *Id.*

88. In re Huff, [1990-91 Transfer Binder] Fed. Sec. Law Rep. (CCH) ¶ 84,719 (March 28, 1991).

PaineWebber Inc., for the alleged failure to supervise a retail salesman and his branch office manager.[89] Huff assisted the entire firm in establishing compliance criteria, while the firm looked to its branch managers to directly supervise its sales staff in all sales activity. Thus, Huff did not directly or indirectly supervise the activities of the retail salesman who committed the underlying fraud. Notwithstanding this, the SEC filed charges alleging Huff had supervisory responsibility for the salesman and his branch manager.[90] An administrative law judge found that Huff had failed to exercise reasonable supervision over both the salesman and the salesman's manager.[91] On appeal, four SEC Commissioners unanimously voted to dismiss the proceeding, but in doing so took two different approaches.

In one opinion, Chairman Breeden and Commissioner Roberts assumed that Huff had the responsibility of supervising the salesman and the branch manager.[92] They then examined whether Huff in fact exercised supervision over the two in accordance with section 15(b)(4)(E). The Commissioners determined that Huff satisfied the reasonableness standard in his compliance efforts over the salesman because he had previously recommended termination of the salesman after analyzing the salesman's customer accounts. The Commissioners dismissed the charge against Huff concerning his alleged deficient supervision of the manager.[93] In deciding this issue, Breeden and Roberts stated that "the 'failure to supervise' by a subordinate is not in and of itself a substantive violation of the securities laws and, therefore, cannot be the predicate upon which a superior can be sanctioned for a second-tier 'failure to supervise.'[94] In their concurring opinion, Commissioners Lochner and Schapiro agreed on the latter issue.[95] Thus, a majority of four SEC commissioners held that an individual with supervisory responsibilities cannot be disciplined for failing to exercise reasonable supervision over another person who did not personally violate the securities laws, but rather was merely sanctioned for failure to supervise his or her subordinate.

While the Breeden-Roberts opinion merely assumed that Huff was responsible for supervising the salesman, the Lochner-Schapiro opinion squarely addressed the issue of staff supervision verses line supervision. Though not adopting a clear staff/line test, the two commissioners noted that in order for section 15(b)(4)(E) to govern a particular situation, a "supervisory relationship" must exist.[96] With the exception of "line supervisors," who have the power to hire, fire, reward or punish, there is difficulty in determining whether one has the supervisory re-

89. *Id.* at 81,395.
90. *Id.* at 81,394.
91. *Id.* at 81,396.
92. *Id.* at 81,397.
93. *Id.* at 81,398.
94. *Id.*
95. *Id.*
96. *Id.* at 81,399.

sponsibility of another. According to Lochner and Schapiro, in the context of staff (non-line) supervision, such a relationship is found only when, inter alia, it should have been clear to the supervisor that he was responsible for the activities of another and that the supervisor had the ability to take effective action to fulfill this responsibility.[97] In effect the two commissioners had announced a definition of the term "supervisor" for purposes of section 15(b)(4)(E). In their view a "supervisor" is a person who "has been given (and knows or reasonably should know he had been given) the authority and the responsibility for exercising such control over one or more specific activities of a supervised person . . . so that such person could take effective action to prevent a violation" of the securities laws or rules.[98]

Thus, in *Huff*, the SEC established that deficient supervision by a subordinate does not in and of itself provide a statutory basis for sanctioning a superior. Absent a clear indication of personal involvement and affirmative wrongdoing on the part of those to whom responsibility is delegated, the SEC will not automatically place liability on senior managers where a violation occurs at a level far removed from them.[99] The SEC's position clearly restricts exposure to liability.

### 3. Secondary Liability Restricted for "Controlling Person" and Respondeat Superior

Investors not only sue brokerage firms under primary liability for inadequately supervising their registered representatives, but in addition they frequently pursue the firm for secondary liability. A brokerage firm faces secondary liability under a number of different theories. In *Lafferty* the plaintiff alleged that the brokerage firm was secondarily liable both as a controlling person and under the doctrine of respondeat superior for the primary violations of its registered representative, Foulke.

Because secondary liability is so well established, courts rarely question its basis[100] even though federal security statutes do not expressly prescribe such liability with the limited exception of "controlling person" provisions.[101] The U.S. Supreme Court has not yet engaged in a

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97. *Id.*

98. *Id.* at 81,401. Under Lochner and Schapiro's analysis, Huff was not the salesman's supervisor because Huff: (1) was not in a position to control the salesman's activities through the traditional methods of reward or punishment and (2) was never clearly given, by his own superiors, authority or responsibility for the salesman's conduct.

At the same time, these Commissioners strongly cautioned that a firm itself may violate the statute if it "fails clearly to assign such supervisory authority and responsibility to specific individuals" as part of its statutory responsibility. *Id.*

99. *Id.* at 81,402.

100. *See* William H. Kuehnle, *Secondary Liability Under the Federal Securities Laws — Aiding and Abetting, Conspiracy, Controlling Person, and Agency: Common-Law Principles and The Statutory Scheme*, 14 J. CORP. L. 313, 315 (1988).

101. Securities Act of 1933 § 15, 15 U.S.C. § 77*o* (1990); Securities Exchange Act of 1934 § 20(a), 15 U.S.C. § 78*t* (1990). A few express provisions for secondary liability under an aiding and abetting theory also exist. For example, section 209(e) of the Investment Advisors Act, 15 U.S.C. § 80b-9(e) (1990), and for broker-dealers, section 15(b)(4)(E) of the Securities Exchange Act of 1934, 15 U.S.C. § 78*o*(b)(4)(E) (1990).

detailed analysis of the application of secondary liability concepts to the federal securities laws.[102] However, it has witnessed such an application.[103] In order to find secondary liability the plaintiff must prove that the primary violator performed the central act proscribed by the statute or rule.[104] The secondary violator acquires liability because he assisted or supported the primary violator's act.[105] or through a relationship with the primary violator. Secondary liability from a relationship can be based on either common-law respondeat superior liability or statutory liability for "controlling persons."[106] Although there are some differences between the principal-agent relationship in agency law and the control relationship in the statutory provisions, the imposition of liability under the two concepts of respondeat superior and control person is quite similar.

Under the common law of agency, a principal may be liable for the conduct of his agent. The doctrine of respondeat superior provides: "A master is subject to liability for the torts of his servants committed while acting in the scope of their employment."[107] Under securities laws there are two provisions which hold controlling persons liable to the same extent as the persons they control. Section 15 of the 1933 Act[108] and section 20(a) of the 1934 Act[109] both hold that a person in control of another who violates the securities laws shall be jointly and severally liable with the violator.

Although the two concepts are quite similar, a critical difference exists regarding good faith. The control person provisions expressly provide relief from liability for proof of good faith;[110] agency principles

102. Keuhnle, *supra* note 100, at 316-17. The Court expressly reserved decision about aiding and abetting in *Hochfelder*. "[W]e need not consider whether civil liability for aiding and abetting is appropriate under the section and the Rule, nor the elements necessary to establish such a cause of action." *Hochfelder*, 425 U.S. at 191-92 n.7

103. *See* Kuehnle, *supra* note 100, at 316-17.

104. *Id.* at 318.

105. *See supra* notes 132-57 and accompanying text for discussion of aider and abettor liability.

106. Kuehnle, *supra* note 100, at 348.

107. RESTATEMENT (SECOND) OF AGENCY § 219(2) (1958).

108. The Securities and Exchange Act of 1933, § 15, 15 U.S.C. § 77*o* (1990) states:
Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other person by or through stock ownership, agency, or otherwise, controls any person liable under sections 77*k* or 77*l* of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

109. The Securities Exchange Act of 1934, § 20(a), 15 U.S.C. § 78t(a) (1988) states:
Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

110. *See* Pharo v. Smith, 621 F.2d 656, 673-74 (5th Cir.), *aff'd in part, remanded in part*, 625 F.2d 1226 (5th Cir. 1980); Carpenter v. Harris Upham & Co., Inc., 594 F.2d 388 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979).

under the doctrine of respondeat superior do not relieve the principal from liability even when he acts in good faith.[111] The principal's liability is, however, limited to the acts done within the scope of the agent's employment.[112] The conflict between the two doctrines concerning good faith has divided the courts over whether the two federal securities provisions are exclusive of common law agency principles.[113] The majority of circuits hold that Congress did not intend to supplant agency law with the controlling person provisions, but enacted the provisions to provide an additional basis of secondary liability.[114] In fact, the majority of courts hold that respondeat superior has concurrent liability with controlling person liability.[115] Nevertheless, under both provisions, liability is derivative. Absent an underlying violation by the controlled person (registered representative), no claim against the controlling person (brokerage firm) may be maintained.[116]

Thus, in order for the plaintiff in *Lafferty* to succeed in an action against the brokerage firm she must have shown: (1) a primary securities violation by the registered representative; and (2) control of that representative by the brokerage firm.[117]

Conversely, substantial disagreement exists between courts regarding the correct operation of "control" in control person liability. The dividing issue is whether the federal provisions apply only to individuals who actively control the primary violator (culpable participation), or whether the provisions also apply to individuals who have a general, rather than a direct, relationship of control over the violator. Courts that mandate culpable participation require the controlling person to have control over the primary violator and to directly exercise that con-

111. *See, e.g.*, New York Cent. R.R. v. White, 243 U.S. 188, 198 (1917) (holding employer who exercised utmost care still liable for acts of employees while acting in scope of employment).

112. *See* Marbury Management, Inc. v. Kohn, 629 F.2d 705, 716 (2d Cir. 1980. *See also* Harrison v. Dean Witter Reynolds, Inc., 715 F. Supp. 1425 (N.D. Ill. 1989) (refusing to impose liability on basis of respondeat superior where broker sold municipal bonds in manner contrary to firm's rules and where transactions were "anything but regular"); Moss v. Morgan Stanley, Inc., 553 F. Supp. 1347 (S.D.N.Y.), *aff'd*, 719 F.2d 5 (2d Cir. 1983) (finding investment banker not liable for acts of employee/tippee because trading on inside information not within the scope of employment); RESTATEMENT (SECOND) OF AGENCY §§ 228-29 (1958) (defining acts within the scope of employment).

113. *See* Kuehnle, *supra* note 90, at 349-54. "The circuits are divided, with the clear majority holding for agency liability and against exclusivity." *Id.* at 349.

114. *Id.* at 350.

115. Gerald F. Rath & David C. Boch, *Selected Issues in Broker/Customer Litigation*, 751 A.L.I.- A.B.A. Course of Study 557 (1992)[hereinafter *Issues*]. This carefully documented work examines each circuit for their rulings on this issue and generally finds none that have expressly denied concurrent liability, with the possible exception of the Third. *Id.*

For the Securities and Exchange Commission's view see the amicus brief in Hollinger v. Titan Capital Appeal No. 87-3887 (9th Cir. file Nov. 9, 1989). *See also Recent SEC Amicus Brief Supports Respondeat Superior Liability in Private Action*, 4 INSIGHTS 1 (Jan. 1990) (respondeat superior liability should be imposed concurrently with the statutory liability of section 20(a) to protect the public).

116. Deviries v. Prudential-Bache Securities, Inc., 805 F.2d 326 (8th Cir. 1986); Roberts v. Heim, 670 F. Supp. 1466 (N.D. Cal. 1987); Baum v. Philips, Appel & Walden, 648 F. Supp. 1518 (S.D.N.Y. 1986).

117. Gruber v. Prudential-Bache Securities, Inc., 679 F. Supp. 165 (D. Conn. 1988).

trol with the intent to bring about a violation. Courts not mandating culpable participation do not require participation by the controlling person in the violation,[118] but some relation between control and the violation is required. The circuit courts' positions suggest that some are inclined to support secondary liability based merely on relationship, while others impose liability based on action.[119]

In those jurisdictions requiring active or culpable participation, the investor-plaintiff must show the controlling person's real control over the violator. This may be shown from the relationship in general—as in showing that the primary violator was an employee of the defendant corporation. The plaintiff must then show that the scope of control included the conduct that was the basis of the primary violation—as in showing that the employee's particular violative conduct was within the scope of the corporation's control. The plaintiff need not show, however, that the control was exercised to cause the violation.

This approach appears to comport with the intent of the statute.[120] It requires the plaintiff to prove the ability to exercise control without having to make the more difficult proof of the actual exercise of the control in this particular violation—a matter within the knowledge of the defendant and relevant to the good faith defense. Thus, in courts following this approach the plaintiff must establish culpable participation before the defendant addresses the good faith defense.[121] In those courts not following the culpable participation approach, however, when the plaintiff establishes the defendant had control over the primary violator the "control" element is satisfied and the burden immediately shifts to the defendant to establish the good faith defense.[122]

The Tenth Circuit appears to have rejected culpable participation. It has imposed liability on brokerage firms for their representative's underlying violation without reference to culpable participation.[123] Therefore, in *Lafferty*, had Ms. O'Connor been able to establish an underlying violation by Foulke, the burden would shift to Lafferty to estab-

118. *See, e.g.*, G.A. Thompson & Co v. Partridge, 636 F.2d 945, 958 (5th Cir. 1981) ("Neither this [regulatory] definition nor the statute appears to require participation in the wrongful transaction.")

119. *See* Kuehnle, *supra* note 100, at 354-55 n.211. Kuehnle found the following different circuit treatments: three circuits appear to require culpable participation (Ninth, Second and Third); five have rejected culpable participation either expressly or impliedly through their analysis of the control elements in a way that is inconsistent with culpable participation (Tenth, Eighth, Seventh, Sixth and Fifth); and the issue is unclear or has not been decided in the remaining circuits (Fourth, First and D.C.). *Id.*

120. *See supra* notes 104-06 and accompanying text.

121. Orloff v. Allman, 819 F.2d 904, 906-07 (9th Cir. 1987); Christoffel v. E.F. Hutton & Co., 588 F.2d 665, 667 (9th Cir. 1978); Gould v. American-Hawaiian S.S. Co., 535 F.2d 761, 779 (3d Cir. 1976); Gordon v. Burr, 506 F.2d 1080, 1086 (2d Cir. 1974);

122. *See* San Francisco-Oklahoma Petroleum Exploration Corp. v. Carstan Oil Co., 765 F.2d 962, 964 (10th Cir. 1985); Paul F. Newton & Co. v. Texas Commerce Bank, 630 F.2d 1111, 1120 (5th Cir. 1980); Hecht v. Harris Upham & Co., 283 F. Supp. 417, 438 (N.D. Cal. 1986).

123. *See, e.g.*, Busch v. Carpenter, 827 F.2d 653, 659-60 (10th Cir. 1987); *San Francisco-Oklahoma Petroleum Exploration Corp.*, 765 F.2d at 964-66; Richardson v. MacArthur, 451 F.2d 35, 41 (10th Cir. 1971).

lish the good faith defense, because of its control of Foulke.[124]

Both statutory provisions make available to the brokerage firm the good faith defense.[125] To prove good faith:

> it is necessary for the controlling person to show that some precautionary measures were taken to prevent an injury caused by an employee. . . . It is required of the controlling person only that he maintain an adequate system of internal control and that he maintain the system in a diligent manner.[126]

The precise standard of supervision required of the brokerage firm to establish the good faith defense is uncertain.[127] However, where the registered representative completes the violative transaction through the employing brokerage and the firm receives a commission on the transaction, the burden of proving good faith is on the brokerage.[128] The brokerage must show that no negligence has occurred in supervision of the registered representative,[129] and that it has maintained and enforced a reasonably reliable system of supervision and internal control over such personnel.[130]Thus, Lafferty could have defended against the secondary liability claim by proving it had maintained and reasonably enforced a proper system of supervision over Foulke—in other words, by establishing the good faith defense.

The doctrine of respondeat superior does not, however, provide such a defense. Under this doctrine the primary focus concerns the scope of employment and whether an employee's acts can fairly be considered within the scope of employment.[131] Here, the only defense available to Lafferty is where Foulke acts beyond the scope of his employment. Obviously, whenever a court restricts the scope of primary liability, it in effect restricts any derivative secondary liability. Again, as a result of the Tenth Circuit's restricting the scope of primary liability for the registered representative in *Lafferty*, the scope of secondary liability for the brokerage firm was also restricted.

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124. As a matter of law, a brokerage firm is a controlling person with respect to its registered representatives. *See* Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990).

125. *See* Carpenter v. Harris Upham & Co., Inc., 594 F.2d 388 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979); Pharo v. Smith, 621 F.2d 656, 673-74 (5th Cir.), *aff'd in part, remanded in part*, 625 F.2d 1226 (5th Cir. 1980) (analogous statutory provisions interpreted similarly).

126. *Carpenter*, 594 F.2d at 394. *Accord* Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990) (stating that to prove good faith broker-dealer must show "supervisory system was adequate and that it reasonably discharged its responsibilities under the system"); Trustman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,936 (C.D. Cal. 1985) (holding that defendant was not in compliance with duty of good faith). *See generally*, Note, *The Burden of Control: Derivative Liability Under Section 20(a) of the Securities Exchange Act of 1934*, 48 N.Y.U.L. Rev. 1019, 1037 (1973) (and cases cited therein).

127. *See Marbury*, 629 F.2d at 716.

128. Stern v. American Bankshares Corp., 429 F. Supp. 818, 823 (E.D. Wis. 1977).

129. SEC v. Geon Industries, Inc., 531 F.2d 39, 54 (2d Cir. 1976); *Gordon*, 506 F.2d at 1085-86.

130. Zweig v. Hearst Corp., 521 F.2d 1129, 1134-35 (9th Cir. 1975).

131. *Marbury*, 629 F.2d at 716.

4. Secondary Liability Restricted for Aiding and Abetting

The case of *Farlow v. Peat, Marwick, Mitchell & Co.*[132] offers further evidence of a Tenth Circuit trend to restrict liability in Rule 10b-5 cases. During the period 1979 until 1986, Patrick Powers and his related entities (collectively Powers) offered and sold over fifty limited partnerships. The limited partners who invested in the offerings claimed that Powers defrauded investors in 58 limited partnerships by making numerous misrepresentations while the partnerships were nothing more than "worthless shells" without value.[133] The plaintiffs further claimed that Peat, Marwick, Mitchell & Company (Peat Marwick), the accounting firm that audited Powers, became "involved in the fraud" in April, 1981, when it agreed to certify the Powers' financial statements, which it knew to be "materially false and inaccurate."[134] The disgruntled limited partners brought suit against the accounting firm for, inter alia, aiding and abetting.[135] The Tenth Circuit upheld the lower court's dismissal of the plaintiffs' claims for failure to allege fraud with particularity under Rule 9(b).[136] The court noted that the allegations failed to specify which plaintiffs had dealt directly with Peat Marwick, from which persons the plaintiffs had purchased their interests, and on which occasions the misrepresentations were made and how they were directed to plaintiffs.[137]

Employers and others, including agents such as accountants and attorneys, can be held liable under an aiding and abetting charge. Although the federal securities laws generally do not provide for such liability[138] and the U.S. Supreme Court has reserved ruling on the issue,[139] courts almost universally infer liability for aiding and abetting by utilizing the joint tortfeasor language in the *Restatement (Second) of Torts*.[140] In order to establish aider and abettor liability under Rule 10b-5, the facts must show a violation by the primary violator, knowledge of that violation by an aider and abettor, and "substantial assistance" by the aider and abettor.[141]

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132. 956 F.2d 982 (10th Cir. 1992).

133. *Farlow*, 956 F.2d at 985.

134. *Id.*

135. *Id.* at 986.

136. Rule 9(b) of the Federal Rules of Civil Procedure provides: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." FED. R. CIV. P. 9(b).

137. *Farlow*, 956 F.2d at 987-89.

138. There are a few provisions of the federal securities laws that expressly provide for aiding and abetting liability. *See, e.g.*, Investment Advisors Act § 209 (e), 15 U.S.C. § 80b-9(e) (1990). Broker-dealers are subject to administrative sanctions for willfully aiding and abetting violations of the federal securities laws. *Id. See also* Securities Exchange Act of 1934 § 15(b)(4)(E), 15 U.S.C. § 78o(b)(4)(E) (1990)(allowing the Commission to censure, place limitations on activities, suspend or revoke the license of broker dealers who willfully aid or abet violation).

139. *See Hochfelder*, 425 U.S. at 191 n.7.

140. *See* Kuehnle, *supra* note 100, at 321-22.

141. Employers Insurance of Wausau v. Paine, Webber, Jackson & Curtis, Inc., [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,792 (S.D.N.Y. 1982). *See* Armstrong v. McAlpin, 699 F.2d 79 (2d Cir. 1983) (aiding and abetting churning allegation against stockbroker sufficient to withstand motion to dismiss); Board of Trustees v. Liberty Group, 708 F. Supp. 1504 (N.D. Ill. 1989). *See generally*, Woods v. Barnett Bank of Fort Lauder-

The second and third elements of aiding and abetting liability present the greatest difficulty. The first element, a violation by a primary violator usually has been decided by the time aiding and abetting liability is being considered. The two difficult elements demand a determination of the level of assistance and knowledge required in order to apply liability for aiding and abetting. In determining the level of assistance required courts turn again to the Restatement, which imposes liability when one person breaches a duty and another gives "substantial assistance or encouragement to the other so to conduct himself."[142] While the defendant may be aware a violation is occurring, unless he acts to aid the violation or fails to act when he had a duty, no liability attaches.[143] The Restatement measures assistance essentially under the principles of causation.[144] An "[a]ctor's negligent conduct [will be] the legal cause of harm to another if . . . his conduct is a substantial factor in the bringing about [of] the harm . . . ."[145] Thus, in determining whether substantial assistance has been given by the aider and abettor, one must find a substantial causal connection between the assistance and the violation. That causal connection can arise from either the aider's action or inaction, as long as the action or inaction caused the harm.[146] In determining the causal connection, and thus the degree of assistance, consideration is given to the number and effect of other variables, and to whether the conduct was harmless until acted upon by other forces or was part of a continuous stream of forces leading to the resulting harm.[147]

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dale, 765 F.2d 1004 (11th Cir. 1985); Cleary v. Perfectune, Inc., 700 F.2d 774 (1st Cir. 1983); Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38 (2d Cir. 1978); Rochez Brothers, Inc. v. Rhoades, 527 F.2d 880, 886 (3d Cir. 1975); Hemming v. Alfin Fragrances, Inc., 690 F. Supp. 239 (S.D.N.Y. 1988).

142. RESTATEMENT (SECOND) OF TORTS § 876(b) (1977).

143. Monsen v. Consolidated Dressed Beef Co., 579 F.2d 793, 800 (3d Cir. 1978) (holding "mere knowledge of a violation alone, without assistance or a duty to disclose the violation, is not an actionable wrong").

144. The cmt. for clause b of § 876 states: "In determining liability, the factors are the same as those used in determining the existence of legal causation when there has been negligence . . . or recklessness . . . ." RESTATEMENT (SECOND) OF TORTS § 876(b), cmt. d (1977). *See also* Mendelsohn v. Capital Underwriters, Inc., 490 F. Supp. 1069, 1084 (N.D. Cal. 1979) (finding there must be substantial causal connection between conduct of alleged aider and abettor and harm to plaintiff).

145. RESTATEMENT (SECOND) OF TORTS § 430, cmt. d (1977).

> It is not necessary that it be *the* cause, using the word 'the' as meaning the sole or even the predominant cause. The wrongful conduct of a number of third persons may also be a cause of the harm, so that such third persons may be liable for it, concurrently with the actor.

*Id.* (emphasis in original).

146. *See* Kuehnle, *supra* note 100, at 342.

> [L]iability for nonaction requires a showing of the breach of a duty or a showing of conscious intent. A breach of duty can constitute causal assistance. If one owed a duty to the plaintiff and the failure to fulfill the duty permitted the harm to occur, the person owing the duty could be said to have assisted the violation. The duty, the breach of which could be said to be a cause of the harm, could arise from a statutory obligation under the securities laws or from another, indirect basis of duty including custom, practice, contract, or special relationship.

*Id.* (footnotes omitted).

147. *See, e.g.*, Wessel v. Buhler, 437 F.2d 279, 282-83 (9th Cir. 1971); RESTATEMENT (SECOND) OF TORTS § 533 (1977). Kuehnle states:

In determining the level of knowledge required for an aider and abettor, the Second Circuit in *Rolf v. Blyth, Eastman Dillon & Co.*,[148] considered whether the Rule 10b-5 standard of knowledge matched the scienter needed for primary 10b-5 liability. The court concluded that "the basic holding of *Hochfelder*, that scienter is an element of the section 10(b)/Rule 10b-5 cause of action, also establishes the standard for aiding and abetting liability."[149] Considering whether recklessness constitutes scienter for an aiding and abetting violation, the Second Circuit concluded that "at least where, as here, the alleged aider and abettor owes a fiduciary duty to the defrauded party, recklessness satisfies the scienter requirement."[150]

Although the issue of recklessness for Rule 10b-5 liability is not fully resolved, it has almost universal acceptance as constituting scienter for primary 10b-5 violations. However, recklessness is not as well accepted for secondary aider and abettor liability. Some courts allow recklessness to satisfy the scienter requirement for aider and abettor liability without any special circumstances.[151] Other courts recognize recklessness as an appropriate standard only under special circumstances. For example, courts requiring special circumstances have allowed recklessness to satisfy the scienter requirement in aider and abettor liability where a fiduciary relationship exists between the victim and the aider and abettor,[152] where the aider and abettor could reasonably foresee that the plaintiff would rely upon his actions[153] and where the aider and

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> Activity that is otherwise harmless does not constitute assistance where the activity has been made harmful by the intervention of other, corrupting forces. Thus, where an accountant prepares interim financial statements for a company and informs the company of deficiencies in the company's books, the accountant is not liable for the subsequent alteration of those statements and their use in a prospectus by another.

Kuehnle, *supra* note 100, at 340 n.154. *But see* SEC v. Spectrum, Ltd., 489 F.2d 535, 541-42 (2d Cir. 1973)(giving opinion letter on securities issue makes securities lawyer participant in stream of events leading to securities transaction; letter may be legal causal factor constituting substantial assistance even if flow of events takes several turns).

148. 570 F.2d 38, 44 (2d Cir. 1977).

149. *Id.*

150. *Id.*

151. *See* Herm v. Stafford, 663 F.2d 669, 684 (6th Cir. 1981) (holding circuit law is either scienter or recklessness is sufficient to fulfill requirement); Edward J. Mawod & Co. v. SEC, 591 F.2d 588, 596 (10th Cir. 1979) (prevailing rule is willful or reckless behavior satisfies scienter requirement).

152. *See* Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004, 1010 (11th Cir. 1985) (holding severe recklessness satisfies scienter requirement in aiding and abetting case, at least where alleged aider and abettor owes duty to defrauded party); Armstrong v. McAlpin, 699 F.2d 79, 91 (2d Cir. 1983) (owing fiduciary duty to plaintiff makes recklessness sufficient for liability for aider and abettor); IIT v. Cornfeld, 619 F.2d 909, 923 (2d Cir. 1980) (noting that fiduciary duty is recognized as special consideration allowing recklessness as satisfaction of scienter requirement for aider and abettor liability); *Rolf*, 570 F.2d at 48 (alleged aider and abettor owing fiduciary duty allows recklessness to satisfy scienter requirement); Hudson v. Capital Mgmt. Int'l, Inc., 565 F. Supp. 615, 624 (N.D. Cal. 1983) (ruling that recklessness only suffices fiduciary or analogous relationship binds defendant to plaintiff).

153. *See Woods*, 765 F.2d at 1011 (following precedent applying "recklessness standard to alleged aiders and abettors who have issued statements or certifications foreseeably relied upon by investors"); Fund of Funds, Ltd. v. Arthur Andersen & Co., 545 F. Supp. 1314, 1356-57 (S.D.N.Y. 1982) (stating although courts generally don't regard accountant-

abettor receives a benefit from the fraud.[154]

Still other courts developed and utilized a sliding scale approach linking the level of knowledge required to the degree of assistance rendered.[155] This approach scales the level of knowledge upward or downward depending upon the amount and type of assistance rendered. A stronger showing of knowledge is required where the assistance is remote or routine.[156] In 1979 the Tenth Circuit followed the less restrictive approach toward aiding and abetting liability and stated "[t]he prevailing rule would appear to be that . . . reckless behavior satisfies the scienter requirement" for aiding and abetting.[157]

However, in *Farlow,* the Tenth Circuit, following the trend of restricting the scope of liability, also stated that it is not the law that whistle-blowing to protect investors is necessitated whenever an accountant discovers his client to be in financial trouble.[158] The failure to disclose material information is actionable only where a duty to disclose arises,—when one party has information that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.[159] The duty to disclose does not arise from the relationship between the parties merely because one party has an ability to acquire information.

The court in *Farlow,* like the *Lafferty* court, affirmatively addressed an issue that did not direct its decision. The facts in *Farlow* permitted the court to dismiss the case for failing to specifically plead fraud pursuant to Rule 9(b).[160] Yet, the court stepped forward and restricted the scope of Rule 10b-5 liability by refusing to adopt the whistleblower or

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client relationship as fiduciary, recklessness standard applies where accountant's misleading audit or opinion letter leads to foreseeable reliance); Morgan v. Prudential Group, Inc., 527 F. Supp. 957, 961 (S.D.N.Y. 1981) (holding that reliance on attorney's tax opinion is foreseeable, and where foreseeability of reliance is apparent recklessness standard may be applied); Investors Funding Corp. of N.Y. Sec. Litig., 523 F. Supp. 550, 558 (S.D.N.Y. 1980) (ruling recklessness sufficient to establish scienter where plaintiff/third party reliance on accountant's audit or opinion letter is reasonably foreseeable).

154. *See* Gould v. American-Hawaiian S.S. Co., 535 F.2d 761, 780 (3d Cir. 1976) (knowledge requirement less strict where alleged aider and abettor derives benefits from wrongdoing).

155. *See, e.g.*, Abell v. Potomac Ins. Co., 858 F.2d 1104, 1126-27 (5th Cir. 1988)(explaining previously adopted test that establishes scienter by relating level of assistance to level of intent); Metge v. Baehler, 762 F.2d 621, 624 (8th Cir. 1985) (holding knowledge and assistance factors vary inversely relative to one another; where evidence of substantial assistance is slim requirement of knowledge or scienter is enhanced); *Cornfeld,* 619 F.2d at 923.

156. *See, e.g.*, Woodward v. Metro Bank, 522 F.2d 84, 95 (5th Cir. 1975) ("scienter requirement scales upward when activity is more remote").

157. Edward J. Mawod & Co. v. SEC, 591 F.2d 588, 596 (10th Cir. 1979).

158. *Farlow,* 956 F.2d at 988.

> "That [whistleblower liability] would be an extreme theory of accountants' liability, and it is one we decline to embrace as an interpretation of the common law of Illinois, having in previous cases specifically rejected it as a possible theory of Rule 10b-5 aider and abettor liability."

*Id.* at 988 (citing Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490 (7th Cir. 1986) and LHLC Corp. v. Cluett, Peabody & Co., 842 F.2d 928, 932-33 (7th Cir. 1988).

159. Chiarella v. United States, 445 U.S. 222, 228 (1980) (quoting RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1976)).

160. *Farlow,* 956 F.2d at 984-89.

financial Good Samaritan theory of liability for accountant liability, thereby refusing to expand the duty to disclose.[161]

## III. CONCLUSION

Although the Tenth Circuit is not a hot bed for securities litigation, it nonetheless is subject to the trend to restrict the scope of Rule 10b-5 liability. Without articulating its position, the Tenth Circuit has illustrated through three decisions last year its reluctance to expand securities fraud liability. Indeed, the court addressed questions restricting Rule 10b-5 liability when such questions were never posed. The Tenth Circuit now requires specific allegations of the who, what, where, when and how in pleading a 10b-5 violation in order to defeat an opposing motion for summary judgment or dismissal. The court also requires the element of control for unsuitability claims based on fraud by conduct and no whistleblower or financial good Samaritan theory of liability exists in the Tenth Circuit. One may argue that these imposed requirements illustrate the Tenth Circuit's willingness to take affirmative steps to reduce securities fraud litigation by restricting liability. Evident from their voiced concerns, the business sector shares an attitude that securities fraud litigation has grown beyond an acceptable limit and affirmative steps need to be taken to reduce liability. This attitude is already apparent in the courts, as witnessed from their application of securities fraud issues. What remains uncertain is whether Congress agrees with this attitude. The answer to that question shall remain a matter of speculation until Congress hears the Senate and House bills in 1993.

*Brent J. Gregoire*

161. *Cf.* The Financial Fraud Detection and Disclosure Act H.R. 4313, 102d Cong., 1st Sess. (1992) (Whistleblower Act) introduced by Rep. Ron Wyden, (D-OR), approved by the full House Energy and Commerce Committee July 28, 1992 and opposed by AICPA. American Banker-Bond Buyer, a Div. of Thomson's Int'l Bank Accountant, 2 U.S. BANK ACCOUNTING LEDGER 38, at 6 (October 12, 1992) *available in* LEXIS, Nexis Library The bill would authorize the SEC to direct independent auditors to investigate their clients for fraud and other wrongdoing. *Id.* The proposal would require auditors to report management fraud to company officials, and also set forth procedures for auditors to follow if they discover potential illegalities during the course of an audit engagement. *Id.*

# TAXATION SURVEY

JAMES SERVEN*

In contrast to the diversified and significant nature of the federal tax cases that came before the Tenth Circuit Court of Appeals in 1991,[1] the court labored through a rather bland and uneventful 1992. While 1992 presented the court with an opportunity to clarify some matters of interest, for the most part the year passed without any major developments. Perhaps as a result of a recessionary economy, or a growing discontent among the taxpaying public, an increasing percentage of the court's time in the tax area seems dedicated to disposing of matters related in one fashion or another to the enforcement of the federal tax laws and the resolution of procedural or administrative disputes between taxpayers and the government, rather than to the interpretation of more substantive tax issues. As more and more citizens encounter difficulties in meeting the tax obligations imposed upon them in a soft economy, the court's opinions increasingly center on challenges — sometimes successful, more often not — to the propriety of the assessment, collection, foreclosure, levy and seizure activities of the Internal Revenue Service. Taxpayers appear more aggressive in attempting to hide their assets, hence an increase in fraudulent conveyance determinations. Tax protestors regularly bring specious constitutional or similar arguments to the court, ultimately claiming that no living human being is subject to federal taxation. These arguments are just as regularly dismissed by the court, occasionally with the imposition of sanctions. Tax issues impacting the distribution of bankruptcy estates occur with more frequency. While the Tenth Circuit addressed many matters meeting these descriptions, virtually no opinion of substantive importance evolved from the court's activities in 1992.

This Survey first examines in detail some of the more noteworthy federal tax cases — noteworthy at least on a relative basis — disposed of by the Tenth Circuit Court of Appeals in 1992.[2] This Survey then concludes by summarizing other opinions handed down by the court in the tax area during the year just past.

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1. *See* James Serven, *Eighteenth Annual Tenth Circuit Survey: Taxation*, 69 DENV. U. L. REV. 1037 (1992).

2. This Survey examines opinions handed down or otherwise first made available by the Tenth Circuit Court of Appeals in 1992, in the area of federal income, estate, and gift taxation.

## I. TIMELY MAILED NOTICE OF DEFICIENCY IS VALID IF RECEIVED TAXPAYER IN MANNER NOT WORKING PREJUDICIAL DELAY, EVEN THOUGH IMPROPERLY ADDRESSED: *SCHEIDT V. COMMISSIONER*[3]

### A. *Background*

The Internal Revenue Code provides that the Commissioner of Internal Revenue must make an assessment of taxes, if at all, within three years after a taxpayer files a return.[4] If the Commissioner determines that there is a deficiency[5] in respect of any tax, the Commissioner is authorized to send a statutory Notice of Deficiency to the taxpayer by certified or registered mail,[6] informing the taxpayer of the deficiency proposed to be assessed by the Commissioner. The mailing of the Notice of Deficiency is a prerequisite to the making of the assessment.[7] The taxpayer to whom the Notice of Deficiency is sent may then file a petition with the United States Tax Court for a redetermination of the deficiency set forth in the Notice.[8] Such a petition must be filed within ninety days after the date of mailing of the Notice of Deficiency.[9] During this ninety day period, the Commissioner is precluded from entering an assessment against the taxpayer in respect of the deficiency proposed in the Notice of Deficiency.[10] However, if the taxpayer fails to timely file a petition for redetermination with the Tax Court within the ninety day statutory period, the Commissioner is directed to assess the deficiency following the expiration of the ninety days.[11] The Commissioner may thereupon commence collection activities against the taxpayer and his assets.

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3. 967 F.2d 1448 (10th Cir. 1992), *cert. denied*, 113 S. Ct. 811 (1992).

4. I.R.C. § 6501(a) (1988). Under certain circumstances, the three-year statute of limitations is extended. For example, if the return omits items of gross income that exceed twenty-five percent of the amount of gross income otherwise reflected in the return, the statutory limitations period is increased to six years. *Id.* § 6501(e)(1). In addition, the statute of limitations is completely open-ended where there has been a false or fraudulent return with the intent to evade tax, where there has been a willful attempt to defeat or evade tax, or where no return has been filed. *Id.* § 6501(c).

5. A "deficiency" is defined in the context of income tax by I.R.C. § 6211(a) to mean, "(1) the excess of the statutorily imposed tax over the total of the amount shown on the taxpayer's return, (2) plus previous assessments, (3) less abatements, credits, refunds, or other prepayments." Keado v. Commissioner, 853 F.2d 1209, 1210 n.1 (5th Cir. 1988).

6. I.R.C. § 6212(a) (1988).

7. *Id.* § 6213(a).

8. *Id.* The Tax Court is the only forum available for the litigation of tax cases which does not require the prepayment of the deficiency. "If the taxpayer fails to timely file a Tax Court petition, but still desires to contest the merits of the deficiency, he must pay the deficiency in full and sue for a refund in a United States District Court or the United States Claims Court." *Keado*, 853 F.2d at 1212, n.10. The Notice of Deficiency, also known as the "90 day letter," has been described as the taxpayer's "ticket to the Tax Court." Delman v. Commissioner, 384 F.2d 929, 934 (3d Cir. 1967), *cert. denied*, 390 U.S. 952 (1968).

9. I.R.C. § 6213(a).

10. *Id.* If the taxpayer does file a timely petition with the Tax Court, the Commissioner is further precluded from assessing the deficiency "until the decision of the Tax Court becomes final." *Id.*

11. *Id.* § 6213(c). An " 'assessment,' essentially a bookkeeping notation, is made when the Secretary or his delegate establishes an account against the taxpayer on the tax rolls." Laing v. United States, 423 U.S. 161, 170 n.13 (1976).

The running of the three-year statute of limitations is tolled during the time that the Commissioner is precluded from assessing a deficiency — that is, for the ninety days following the mailing of the Notice of Deficiency — and for sixty days thereafter.[12] Whether or not a Notice of Deficiency has been validly delivered to the taxpayer so as to be sufficient to toll the statute of limitations can be a question of crucial importance to the Commissioner, particularly where the Notice is sent just prior to the expiration of the three-year period. In the case of an income tax deficiency, the Internal Revenue Code provides the Commissioner with a safe harbor which states that a Notice of Deficiency will be deemed sufficient if it is mailed by certified or registered mail to the taxpayer at his "last known address."[13] Thus, if the Commissioner mails the Notice by certified or registered mail to the taxpayer's last known address,[14] the Notice will operate to suspend the statute of limitations as to the taxpayer, despite the fact that the taxpayer may never receive the Notice and may therefore be unaware of the proposed assessment.[15] Such a Notice provides a form of *deemed* notification to the taxpayer.

If the Notice of Deficiency is *not* sent to the taxpayer's last known address, the safe harbor will not operate to toll the statute of limitations. However, it may happen that the taxpayer, in fact, ultimately receives the Notice, even though it was improperly addressed, such as where the Notice is simply forwarded through the mails to the taxpayer's current, correct address. In such circumstances, the safe harbor will be unavailable to the Commissioner. The courts have generally held, however, that when the Commissioner has been successful in providing the taxpayer with *actual* notice of the proposed assessment, even though the Notice, although timely mailed, was not sent to the taxpayer's last known address, the Notice is sufficient to suspend the statute of limitations as of the date of mailing *if* there has been no delay in the taxpayer's receipt of the Notice that would prejudice the taxpayer's ability to timely file his petition with the Tax Court.[16]

12. I.R.C. § 6503(a)(1). The statute of limitations is further tolled during the pendency of court proceedings, if a Tax Court petition is timely filed. *Id.*

13. *Id.* § 6212(b)(1).

14. The Internal Revenue Service is required to use "reasonable diligence" to ascertain the taxpayer's correct address. Cyclone Drilling, Inc. v. Kelley, 769 F.2d 662, 664 (10th Cir. 1985). *See also* Gullen v. Barnes, 819 F.2d 975, 977 (10th Cir. 1987).

15. In a 1992 decision that was not officially reported, the court of appeals upheld a determination by the district court that a Notice of Deficiency had been timely mailed to the taxpayer's last known address, and thus, the district court had no jurisdiction to hear the taxpayer's action to enjoin the Service from imposing liens and levies against his property. Howell v. United States, No. 92-3016, 1992 U. S. App. LEXIS 32709 (10th Cir. Dec. 11, 1992).

16. *See, e.g.*, Borgman v. Commissioner, 888 F.2d 916, 918 (1st Cir. 1989) (Notice of Deficiency was mailed to the taxpayer in Chicago, then immediately forwarded to him at correct address in Acton, Massachusetts, so as to be received five days after mailing and two days prior to the date the statute of limitations would run. The court stated that: "[a] notice of deficiency that is actually received without delay prejudicial to the taxpayer's ability to petition the Tax Court is sufficient to toll the statute of limitations as of the date of mailing."); McKay v. Commissioner, 886 F.2d 1237, 1239 (9th Cir. 1989) ("[I]f mailing results in actual notice without prejudicial delay . . . it meets the conditions of § 6212(a) no

B. *Facts*

William and Wanda Scheidt filed their 1978 federal income tax return on June 15, 1979. On June 9, 1982, six days before the expiration of the three-year statutory limitation period, the Commissioner of Internal Revenue mailed a Notice of Deficiency to the Scheidts, proposing a deficiency with respect to their 1978 return.[17] The Notice was sent by certified mail, addressed to the Scheidts at Post Office Box 20711, Oklahoma City, Oklahoma. At that time, however, Box 20711 was not the correct mailing address for the Scheidts. Sometime during 1981, the Scheidts had relinquished Box 20711, and had begun renting Box 20748. Both boxes were located at the Village Branch of the Post Office. On December 31, 1981, the forwarding order from Box 20711 to Box 20748 expired.

On May 19, 1981, the Scheidts had informed the Internal Revenue Service[18] that all notices and other correspondence from the Service to the Scheidts should be sent to their home address.[19] Pursuant to a Power of Attorney granted on Form 2848 to their accountant, Robert J. Drewell, and filed with the Commissioner, the Scheidts also directed the Commissioner to send copies of all such correspondence to Mr. Drewell.[20] The Commissioner did not send duplicate originals of the Notice of Deficiency to the Scheidts home address, to Box 20748, or to Mr. Drewell.

On or about June 10, 1982, the Village Branch Post Office received the Notice of Deficiency. Although a notice was placed in Box 20711 informing the Scheidts of the certified letter, it was not picked up. Subsequently, on July 6, 1982, the letter was placed in Box 20748. William Scheidt then picked up the letter and signed for it on that date.[21] Measured from July 6, 1982, the Scheidts, therefore, did not receive the No-

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matter to what address the notice successfully was sent.") (quoting Clodfelter v. Commissioner, 527 F.2d 754, 757 (9th Cir. 1975), *cert. denied*, 425 U.S. 979 (1976)). *See also* Lakota v. Commissioner, No. 90-1796, 1991 U.S. App. LEXIS 2833 (1st Cir. Feb. 15, 1991) (misaddressed Notice mailed on February 21, 1989, was actually received by taxpayer sometime in March, well before the May 22 date by which his Tax Court petition would need to be filed; held, the Notice was sufficient to toll the statute of limitations); Pugsley v. Commissioner, 749 F.2d 691 (11th Cir. 1985) (taxpayer not prejudiced when a Notice of Deficiency misaddressed to Tampa, Florida, was immediately forwarded to taxpayer's correct address in St. Mary, Georgia). For an extreme case, see Boccutto v. Commissioner, 277 F.2d 549 (3rd Cir. 1960) (Notice mailed on November 13, 1959, and returned undelivered is nevertheless sufficient when personally handed to the taxpayer at Internal Revenue Service office on January 21, 1960). *Cf.* Sicker v. Commissioner, 815 F.2d 1400 (11th Cir. 1987) (misaddressed notice of deficiency not sufficient to toll statute of limitations where notice not received by taxpayer until eighty-seven days after its mailing and eight days prior to expiration of ninety-day period for filing petition with Tax Court).

17. The Notice also proposed a deficiency arising out of the Scheidts' 1979 federal income tax return.

18. The Internal Revenue Service is sometimes referred to herein as the "Service."

19. Scheidt v. Commissioner, 49 T.C.M. (CCH) 1501 (1985).

20. *Id.* Mr. Drewell began renting Box 20711 after it was relinquished by the Scheidts. Mr. Scheidt and Mr. Drewell had "office shared" since May of 1981. *Id.*

21. The record is unclear as to how the letter found its way to Box 20748. Presumably, personnel at the Village Branch Post Office were aware of the Scheidts' new box and simply placed the letter there.

tice of Deficiency until twenty-one days after the expiration of the three-year statute of limitations, twenty-seven days after the mailing of the Notice, and sixty-three days prior to the date that the Scheidts would be required to file a timely petition with the Tax Court to contest the proposed assessment, assuming the Notice was valid.

On September 4, 1992, the Scheidts timely filed a petition with the Tax Court with respect to the 1978 deficiency. The Scheidts then filed a motion to dismiss the case for lack of jurisdiction and a motion for summary judgment, on the theory that the Notice of Deficiency was not timely mailed to them and that the Notice, therefore, did not toll the three-year statute of limitations. If the statute of limitations had not been tolled, the Notice must then be considered untimely, and there could be no valid assessment of the proposed deficiency relating to 1978.

C. *Result in the Tax Court*

In a 1985 memorandum opinion,[22] the Tax Court denied both motions filed by the Scheidts, holding that, although the Notice of Deficiency had not been mailed to the Scheidts' last known address and the constructive notice safe harbor did not apply, nevertheless, the Scheidts did in fact receive the Notice in time to file a timely petition with the Tax Court. Thus, because the Notice had been timely mailed by the Service and received by the Scheidts with ample time to file their Tax Court petition, the Scheidts were not prejudiced by the delay. Therefore, the Notice served to toll the three-year statute of limitations.

D. *The Tenth Circuit's Opinion*

On appeal, the Tenth Circuit Court of Appeals affirmed the Tax Court.[23] Citing cases decided in the other circuits,[24] the Tenth Circuit Court of Appeals noted the established rule that where the taxpayer receives actual notice of a proposed assessment in the form of a Notice of Deficiency that was timely mailed prior to the expiration of the three-year statute of limitations to an address other than the taxpayer's last known address, the Notice will nevertheless operate to toll the statute of limitations *if* there has been no delay prejudicial to the taxpayer resulting from the fact that the Notice was not sent to his last known address. Here, the court felt — and the taxpayers had in fact stipulated[25] — that the Scheidts were not prejudiced by having sixty-three days to prepare and file their Tax Court petition prior to the expiration of the ninety day statutory period.

On appeal, the Scheidts attempted to convince the Tenth Circuit Court of Appeals that a Notice of Deficiency is not sufficient to toll the statute of limitations unless: (1) the Notice is mailed prior to the expira-

22. Scheidt v. Commissioner, 49 T.C.M. (CCH) 1501 (1985).
23. The three-judge panel consisted of Judge Moore, Judge Engle, and Judge Tacha.
24. *See supra* note 16 for the cited cases and additional cases.
25. *Scheidt*, 967 F.2d. at 1451, n.5.

tion of the three-year statute of limitations, *and* (2) the Notice is received by the taxpayer in "the due course of the mail."[26] The Scheidts fashioned their two-part test in reliance upon language appearing in prior cases that apparently relied in part upon the fact that the misaddressed letter was delivered in "due course."[27] The Scheidts argued that because the Notice was not received by them until twenty-seven days after its mailing, it was not received in the due course of the mail. The Tenth Circuit was not persuaded, noting that the statute only requires the Notice of Deficiency to be *mailed* in a timely fashion, and does not explicitly tie the effectiveness of the Notice to its *receipt* by the taxpayer. The court thus declined to accept the Scheidts' invitation to "graft an additional prerequisite to the tolling of the limitations period based on whether a taxpayer *receives* the notice of deficiency in the due course of the mails."[28]

The Scheidts also argued that a constructive "remailing" of the Notice of Deficiency had occurred through the act of the Notice having been voluntarily placed in the Scheidts' new Post Office box by the Postal Service. If that theory were correct, the date of mailing of the Notice could no longer be considered as June 9, 1982, and would have to be considered as the date the Notice was placed in the new Post Office box. That later date fell outside the three-year statute of limitations. According to the Scheidts, such a "remailing" was, therefore, not timely, and did not operate to toll the statute of limitations. The Tenth Circuit Court of Appeals was not impressed by the Scheidts' argument of "constructive remailing" and simply noted that, in fact, the Commissioner had mailed the Notice only once.[29]

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26. *Id.* at 1451.

27. In the Tax Court, the Scheidts had relied on language in Frieling v. Commissioner, 81 T.C. 42 (1983), to the effect that "[t]he notice [at issue in that case] complied with section 6212(a) because petitioners received it *in due course* through the Postal Service and filed a timely petition in this Court." *Id.* at 60-61 (emphasis added). The Scheidts also relied upon Sicker v. Commissioner, 815 F.2d 1400 (11th Cir. 1987), discussed *supra* note 16, as support for their two-part test. *See also* Zikria v. Williams, 535 F. Supp. 481, 485 (W.D. Pa. 1982) ("[W]here the notice is sent to the wrong address *but delivered to the taxpayer in due course*, there is no prejudice to the taxpayer and the notice is valid.") (emphasis in original).

28. *Scheidt*, 967 F.2d at 1451. The Tax Court, in response to the Scheidts' reliance on *Frieling*, had stated that it did not read the *Frieling* opinion "as requiring a two-step test to be met." Scheidt v. Commissioner, 49 T.C.M. (CCH) 1501, 1504 (1985). The Tax Court concluded that Frieling stands only for the proposition that "petitioners must not be prejudiced by the misaddressing, and must be able to timely file a petition with the Tax Court." *Id.* "The significant factor in the Frieling case, as in the instant case, is that petitioners eventually received the notice and were afforded ample opportunity to file a petition." *Id.* at 1504-05. In response to the Scheidts' reliance upon the *Sicker* case, *supra* note 16, the Tenth Circuit found it easy to distinguish that case (where the taxpayers were afforded only eight days to prepare their Tax Court petition) with the instant case (where the Scheidts had sixty-three days to file such a petition). *Scheidt*, 967 F.2d at 1451.

29. The Tax Court opinion noted that "[d]uring the period from June 25, 1982, to July 6, 1982, it is unclear what happened to the certified letter." *Scheidt*, 49 T.C.M. (CCH) at 1503. The Scheidts had attempted to fill this gap by contending that the letter *was* in fact returned to the Commissioner, who simply deposited it back in the mail. As to this "proposed scenario," the Tax Court noted that the taxpayers had the burden of proof, but were "unpersuasive on this point." *Id.*

E. *Summary*

The crux of the Scheidts' complaint centers around the fact that employees of the Village Branch of the Postal Office apparently took it upon themselves to locate the Scheidts' correct Post Office box and placed the misaddressed Notice of Deficiency in it, rather than return the Notice to the Commissioner. It would have been true that, had the Postal Service returned the certified letter to the Commissioner following the expiration of the three-year statute of limitations,[30] and had the Commissioner then remailed it to the proper address, the Notice would by that time have been untimely and the statute of limitations for the 1978 tax year would have passed in the Scheidts' favor. The Scheidts thus felt aggrieved that they were placed in a worse position than taxpayers who are mailed misaddressed Notices of Deficiency that are returned to the Commissioner after the limitations period has passed. While conceding that such a distinction among taxpayers does exist, the Tenth Circuit Court of Appeals concluded that the distinction was "reasonable,"[31] noting that:

> Given Congress' decision that the date of *mailing* tolls the limitations period, a clearly rational distinction exists between those taxpayers that receive a notice mailed before the three-year period expires and those who do not.[32]

The opinion of the Tenth Circuit Court of Appeals in *Scheidt* shows the court to be in accord with the views espoused in other circuits, as well as existing precedent in the Tenth Circuit. Where a taxpayer is not prejudiced by a delay in receiving a Notice of Deficiency that has been timely mailed by the Commissioner, the Notice will operate to toll the applicable statute of limitations, despite the fact that the Notice was misaddressed, and regardless of the manner in which the Notice ultimately finds its way into the hands of the taxpayer.[33]

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30. The taxpayers argued that the Postal Service, pursuant to Postal Service regulations, should have sent the Notice of Deficiency back to the Commissioner rather than place it in their new box. Normally, the Post Office leaves three notices for the patron, and if the letter remains unclaimed after fifteen days, the letter is returned to the sender. *Scheidt*, 49 T.C.M. (CCH) at 1503.

31. *Scheidt*, 967 F.2d at 1452.

32. *Id.*

33. The Scheidts fared appreciably better in 1992 with the malpractice action they brought against the tax attorney who represented them in connection with their participation in the ill-fated International Monetary Exchange tax shelter litigation. *See* Scheidt v. Klein, 956 F.2d 963 (10th. Cir. 1992).

## II. TENTH CIRCUIT CLARIFIES RELIEF AVAILABLE IN QUIET TITLE ACTIONS AND ACTIONS FOR INJUNCTIONS UNDER STATUTORY EXCEPTION TO ANTI-INJUNCTION ACT: *GUTHRIE V. SAWYER*[34] AND *JAMES V. UNITED STATES*[35]

### A. *Background*

The statutory provisions of the Internal Revenue Code governing the manner in which a taxpayer is informed of the existence of a proposed assessment against him have been summarized above.[36] The main purposes of a Notice of Deficiency are to apprise the taxpayer of the proposed assessment, and to provide the taxpayer with the opportunity to file a petition with the Tax Court to obtain a redetermination of the deficiency giving rise to the assessment. Such a petition must be filed within ninety days of the date of mailing of the Notice of Deficiency.[37] If the taxpayer does not file a petition with the Tax Court, the Internal Revenue Service may immediately assess the deficiency against that taxpayer upon the expiration of the ninety day statutory period.[38] On the date of assessment, a general tax lien arises in favor of the United States, against all the real and personal property of the taxpayer.[39]

The Internal Revenue Code requires that the Commissioner must provide the taxpayer with a Notice of Assessment and Demand for Payment within sixty days after entering an assessment against the taxpayer.[40] The notice and demand states the amount of the assessment, and makes demand upon the taxpayer for payment. If the deficiency is not paid, the Internal Revenue Service may pursue collection activities against the taxpayer, including asserting the government's rights under its general tax lien, described above. The government is also authorized to levy upon and seize the taxpayer's property to recover the assessment, after mailing a notice of intent to levy to the taxpayer.[41]

Taxpayers often find themselves in the position of desiring to challenge the collection activities of the Internal Revenue Service, although the ninety-day period for filing a petition with the Tax Court may ostensibly have already passed. Among other grounds, the taxpayer may claim (1) that the assessment and collection were invalid because the Notice of Deficiency was defective or never sent; (2) that the tax assess-

34. 970 F.2d 733 (10th Cir. 1992).
35. 970 F.2d 750 (10th Cir. 1992).
36. *See supra* text accompanying notes 4-16.
37. *See supra* text accompanying note 9.
38. *See supra* text accompanying note 11.
39. I.R.C. § 6321 (1988).
40. *Id.* § 6303(a).
41. *Id.* § 6331, which authorizes the Service to "levy upon all property and rights to property . . . belonging to such person . . . ," including salaries and wages. The notice of intent to levy must be provided by the Service thirty days prior to levy. *Id.* § 6331(d)(2). Strict compliance with the statutory requirement that a notice of intent to levy be sent to the taxpayer is a prerequisite to the validity of a levy. *See* United States v. Potemkin, 841 F.2d 97, 101-02 (4th Cir. 1988).

ment was never entered or was otherwise procedurally infirm; (3) that the Service never mailed the Notice of Assessment and Demand for Payment to the taxpayer, or there were other defects in the notification process regarding the assessment; (4) that there were defects or irregularities in the tax lien or the Service's procedures in enforcing the lien; or (5) that the Service never mailed a notice of intention to levy or there were other procedural defects in the levy process. To be able to obtain a forum for litigating such claims, the taxpayer must bring suit under a statute that waives the sovereign immunity of the United States.[42] Generally speaking, the Anti-Injunction Act[43] prohibits suits restraining the assessment or collection of federal taxes.[44]

In the tax area, there are two major exceptions to the general bar of the Anti-Injunction Act. First, the Anti-Injunction Act itself specifically recognizes that suits may be brought under I.R.C. § 6213(a), which authorizes an injunction prohibiting an assessment or levy when the taxpayer has not received a notice of deficiency.[45] Second, 28 U.S.C. § 2410 authorizes civil actions against the United States to, *inter alia*, "quiet title to . . . real or personal property on which the United States has or claims a mortgage or other lien."[46]

Beyond this, there remains some uncertainty as to the nature and scope of the challenges that may be mounted by a taxpayer bringing an action pursuant to these two statutes, and as to the relationship between them. For example, in a quiet title action under section 2410, may a taxpayer challenge the sufficiency of the Notice of Deficiency? The courts are in disagreement. In *Elias v. Connett*,[47] the Ninth Circuit Court of Appeals determined that it did not have jurisdiction under section 2410 to consider the taxpayer's claim that the Commissioner's Notice of Deficiency was defective, as that claim went to "the merits of [the taxpayer's] assessment rather than the procedural validity of the lien."[48] On the other hand, the Third Circuit in *Robinson v. United States*[49] allowed the lack of a Notice of Deficiency to be challenged in a quiet title

42. *See generally* United States v. Dalm, 494 U.S. 596 (1990).

43. I.R.C. § 7421(a) (1988). With certain exceptions, this Act provides that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." *Id.*

44. In addition, the Declaratory Judgment Act specifically prohibits declaratory judgments in matters relating to federal taxes. 28 U.S.C. § 2201 (1988).

45. I.R.C. § 6213(a) (1988) provides, in part, that "[n]otwithstanding the provisions of section 7421(a), the making of [an assessment of a deficiency] or the beginning of [a levy or proceeding in court for the collection of a deficiency] during the time such prohibition is in force may be enjoined by a proceeding in the proper court."

46. *See* I.R.C. § 6212(c)(1) (1988) for the other statutory exception to the Anti-Injunction Act. In addition, if the evidence shows that the government could not ultimately prevail and if equity jurisdiction otherwise exists because of extraordinary circumstances, injunctive relief may be available to protect a taxpayer from collection activities. *See* Enochs v. Williams Packing & Navigation Co., 370 U.S. 1 (1962). *See also* Overton v. United States, 925 F.2d. 1282, 1284 (10th Cir. 1991); Lonsdale v. United States, 919 F.2d 1440, 1442 (10th Cir. 1990).

47. 908 F.2d 521 (9th Cir. 1990).

48. *Id.* at 527.

49. 920 F.2d 1157 (3d Cir. 1990).

action, apparently concluding that the taxpayer had no other forum in which to raise the issue, and thus a failure to extend jurisdiction would block the taxpayer's access to the courts and "impugn the procedural validity of the assessment."[50]

The *Robinson* opinion indicated that a taxpayer may be required to show the lack of a remedy at law to invoke the statutory exceptions to sovereign immunity, and that injunctive relief will be unavailable if the taxpayer has such a remedy. The *Robinson* court noted that an adequate remedy at law may be provided by the taxpayer's right to pay the deficiency and sue for a refund.[51] Must the taxpayer show the lack of a remedy in order to invoke the statutory exception from the Anti-Injunction Act found in section 6213(a)? The weight of authority answers this question in the affirmative.[52]

The Tenth Circuit's views on these issues are not fully developed. In *Schmidt v. King*,[53] the court considered the scope of relief available to a taxpayer in a section 2410 quiet title actin. In *Schmidt*, the court affirmed that "[w]hen the taxpayer challenges the procedural regularity of the *tax lien* and the procedures used to enforce the *lien*," sovereign immunity is waived under section 2410.[54] On the other hand, the court concluded that, contrary to the *Robinson* case,[55] challenges to a Notice of Deficiency may not be brought in a section 2410 action, as section 2410 is "not to be construed as permitting a collateral attack on the merits of a tax assessment."[56] Finally, as to whether the taxpayer may claim that the tax assessment is procedurally infirm, the court answered in the negative, stating that "[s]ection 2410 does not extend to challenges for procedural irregularities in assessment or collection of taxes" where the validity of a tax lien is not at issue.[57] The *Guthrie v. Sawyer*[58] and *James v. United States*[59] cases provided the Tenth Circuit with an opportunity to reconsider these views.

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50. *Id.* at 1161.

51. *Id.* at 1160. *See supra* note 8.

52. *See* Lovell v. United States, 795 F.2d 976, 977 (11th Cir. 1986); Flynn v. United States, 786 F.2d 586, 591 (3d Cir. 1986); Perlowin v. Sassi, 711 F.2d 910, 912 (9th Cir. 1983); Cool Fuel, Inc. v. Connett, 685 F.2d 309, 313 (9th Cir. 1982); Philadelphia & Reading Corp. v. Beck, 676 F.2d 1159, 1163 (7th Cir. 1982).

53. 913 F.2d 837 (10th Cir. 1990).

54. *Id.* at 839 (emphasis added). *See also* Hughes v. United States, 953 F.2d 531 (9th Cir. 1992); Stoecklin v. United States, 943 F.2d 42, 43 (11th Cir. 1991); Arford v. United States, 934 F.2d 229, 232 (9th Cir. 1991); McCarty v. United States, 929 F.2d 1085 (5th Cir. 1991); Kulawy v. United States, 917 F.2d 729, 733 (2d Cir. 1990).

55. 920 F.2d 1159 (3d Cir. 1990). *See supra* note 49 and accompanying text.

56. *Schmidt*, 913 F.2d at 839. *See also* Pollack v. United States, 819 F.2d 144 (6th Cir. 1987); Egbert v. United States, 752 F. Supp 1010, 1014 (D. Wyo.), *aff'd*, 940 F.2d 1539 (10th Cir. 1990).

57. *Schmidt*, 913 F.2d at 839.

58. 970 F.2d 733 (10th Cir. 1992).

59. 970 F.2d 750 (10th Cir. 1992).

## B. Guthrie v. Sawyer[60]

### 1. Facts

James and Beatrice Guthrie and Wayne and Dorothy Wells had been issued Notices of Deficiency to which they had not responded. Following the expiration of the ninety-day statutory period, the Internal Revenue Service assessed deficiencies against them, and in the context of the Service's collection activities, asserted tax liens against certain property they owned. As to the Wellses, levy and seizure activities were commenced. The taxpayers brought quiet title actions under section 2410 and actions seeking injunctions under section 6213(a), in the course of which they challenged various aspects of the government's actions in assessing the tax and pursuing collection. The cases were ultimately consolidated. While some of the taxpayers' claims were clearly without merit,[61] nevertheless, it was incumbent upon the court to determine whether the court had jurisdiction over the claims under the two statutes.

### 2. Results in the District Court

The Guthries had first claimed that they had not been mailed a Notice of Deficiency. Contrary to this claim, however, the record indicated that on March 12, 1986, the Commissioner had mailed a Notice of Deficiency by certified mail to James Guthrie, addressed to a Post Office box in Jennings, Oklahoma. Although the Guthries alleged that the Internal Revenue Service had not followed its own procedures in ascertaining their "last known address,"[62] it was essentially uncontroverted that this Post Office box was in fact the Guthries' last known address. After notices left in the Post Office box were ignored, the Notice was returned to the Internal Revenue Service, marked "unclaimed," on March 29, 1986.

In a decision not officially reported,[63] the district court ruled that the section 6213 exception to the Anti-Injunction Act waives sovereign immunity as to this claim. The district court then held on the evidence that a Notice of Deficiency had in fact been sent to the Guthries at their last known address.[64] Thus, the Notice was sufficient to toll the applicable statute of limitations, and the government's assessment was timely. The Guthries also contended that the tax liens asserted by the govern-

60. 970 F.2d 733 (10th Cir. 1992).

61. The taxpayers were apparently "tax protestors." For example, in the district court proceedings, Guthrie raised various constitutional arguments, such as that the assessment was invalid because the federal income tax is a constitutionally proscribed direct tax on income without apportionment, and that Guthrie was not a "person" required to pay income taxes. The district court properly rejected these specious arguments. *See* Guthrie v. Sawyer, 89-1 U.S. Tax Cas. (CCH) ¶9139, at 87,134 (N.D. Okla. 1989). Such "tired arguments are the repertory of the tax protest movement," and have been labelled "sanction-bait." United States v. Buckner, 830 F.2d 102, 103 (7th Cir. 1987) (citations omitted).

62. *See supra* text accompanying note 13.

63. Guthrie v. Sawyer, 1989-1 U.S. Tax Cas. (CCH) ¶ 9139, at 87,134 (N.D. Okla. 1989).

64. *Id.* at 87,136.

ment against certain of their property were invalid because the government had not adhered to its own written procedures in making the assessment that gave rise to the liens.[65] Again, the record showed that this was not the case.[66] The district court ruled that the quiet title statute waives sovereign immunity as to this claim.[67] On the merits, however, the claim was not successful, and the district court held the assessment and the liens to be valid.

Finally, the Wellses asserted various claims in connection with the levy and seizure of their property. The Wellses claimed that the government had failed to record the assessment against them, had failed to issue a Notice of Assessment and Demand for Payment,[68] and had failed to issue a notice of intent to levy. Relying on the above-quoted language in *Schmidt*,[69] the district court held that the quiet title statute does *not* waive sovereign immunity as to these claims, as the validity of a tax lien was not at issue. The district court granted summary judgment for the Commissioner.

### 3. The Tenth Circuit's Opinion

On appeal, the Tenth Circuit Court of Appeals[70] affirmed the district court as to its disposition of the issues concerning the Guthries, but reversed as to the matters concerning the Wellses. The court of appeals had no difficulty in agreeing with the district court that the section 6213 exception to the Anti-Injunction Act waives sovereign immunity as to the Guthries' claims attacking the validity of a Notice of Deficiency, and that section 2410, the quiet title statute, waives sovereign immunity as to the Guthries' claims contesting the validity of the government's tax lien.[71]

As to the claims raised by the Wellses, however, the Tenth Circuit Court of Appeals reversed the district court's conclusion that no waiver of sovereign immunity is worked by the quiet title statute.[72] The matter was therefore remanded for further proceedings, to allow the Wellses the opportunity to develop their challenge.[73] In reversing the district

65. *Id.*

66. The government submitted Certificates of Assessment and Payments on various Forms 4340, detailing the assessments against the Guthries. *Id.* Such certificates are "routinely used to prove that tax assessment has in fact been made." Geiselman v. United States, 961 F.2d 1, 4 n.1 (1st Cir. 1992) (citation omitted). *See also* Hughes v. United States, 953 F.2d 531, 535 (9th Cir. 1992); Gentry v. United States, 962 F.2d 555, 557 (6th Cir. 1992); United States v. Chila, 871 F.2d 1015, 1017-18 (11th Cir. 1989), *cert. denied*, 493 U.S. 975 (1989); United States v. Miller, 318 F.2d 637, 639 (7th Cir. 1963); United States v. Nuttall, 713 F. Supp. 132, 135 (D. Del. 1988), *aff'd*, 893 F.2d 1332 (3d Cir. 1989); United States v. Dixon, 672 F. Supp. 503, 505-06 (M.D. Ala. 1987), *aff'd*, 849 F.2d 1478 (11th Cir. 1988).

67. *See Geiselman*, 961 F.2d 1.

68. *See supra* text accompanying note 40.

69. *See supra* text accompanying note 56.

70. The three-judge panel consisted of Chief Judge McKay, Judge Seymour, and Judge Ebel.

71. Guthrie v. Sawyer, 970 F.2d 733, 737 (10th Cir. 1992).

72. *Id.* at 739.

73. *Id.*

court as to the disposition of the Wellses' claims, the court of appeals was forced to reexamine its determination in *Schmidt* that "[s]ection 2410 does not extend to challenges for procedural irregularities in assessment of collection of taxes."[74] Perceiving an "inconsistency" between other statements in *Schmidt* and this latter statement, the court of appeals proceeded to "disapprove the latter statement and specifically hold that [the quiet title] statute *does* waive sovereign immunity with respect to procedural violations arising from assessment, levy, and seizure."[75] Thus, "[u]nder our holding today, procedural deficiencies with respect to recording assessments and issuing notices and demands for payment may now be brought under section 2410."[76] An "alleged failure of the IRS to assess properly or to send valid notices of assessment and demands for payment are procedural defects cognizable in a quiet title suit."[77]

The court also felt inclined to "take this opportunity to discuss the interrelationship of the quiet title statute and the statutory exception to the Anti-Injunction Act, and to clarify those challenges that may properly be brought under each provision."[78] The court first took issue with the holding of *Robinson* and similarly-decided cases which held that a taxpayer must show a lack of remedy at law to invoke the section 6213(a) exception to the Anti-Injunction Act.[79] Noting that "[o]ne leading commentator has stated that '[s]ection 6213 does not require a showing of irreparable injury as a prerequisite to injunctive relief,' "[80] the court adopted this as the "better view:"

> The purpose of the statutory exception is to preserve the taxpayer's right to litigate his tax liability in the Tax Court *before* paying the tax. If the availability of a refund suit after payment prohibits the taxpayer from obtaining an injunction to protect his right to litigate first, that right is virtually meaningless. Under this approach, this right would be available only on a showing that the taxpayer could not pay the tax. We have difficulty believing that Congress intended to give with one hand and take back with the other.[81]

The Tenth Circuit Court of Appeals then noted that, unlike the result in *Robinson*, the court in *Elias*[82] had *not* allowed the taxpayer to raise defects in a Notice of Deficiency in the context of a quiet title action.[83] As seen above, this ultimate holding is consistent with the Tenth Cir-

74. *Id.* at 735.
75. *Guthrie*, 970 F.2d at 735 (emphasis added).
76. *Id.* at 739. A claim that the Service never sent a notice of intent to levy also falls within the jurisdictional scope of section 2410. *See* National Commodity & Barter Ass'n v. Gibbs, 886 F.2d 1240, 1246 n.6 (10th Cir. 1989).
77. *Guthrie*, 970 F.2d at 737.
78. *Id.* at 736.
79. *Id.* at 736-37; *see also supra* note 52 and accompanying text.
80. *Guthrie*, 970 F.2d at 736 (quoting J. MERTENS JR., MERTENS LAW OF FEDERAL INCOME TAXATION § 49E.39 (1991)).
81. *Id.* at 736.
82. *See supra* text accompanying note 47.
83. *Guthrie*, 970 F.2d 736.

cuit's view. Nevertheless, the Tenth Circuit found itself unable to "agree with that court's apparent position that a taxpayer invoking the statutory exception to the Anti-Injunction Act premised on the failure to receive a Notice of Deficiency must also show the lack of an adequate remedy at law."[84] Thus, while in accord with the ultimate holding of *Elias*, the Tenth Circuit was not in agreement with its reasoning: "In sum, we hold that a taxpayer may obtain injunctive relief under section 6213(a) based on the failure to receive a deficiency notice *notwithstanding* the availability of a refund suit."[85] The court reiterated, however, that "a taxpayer is not entitled to raise [the] procedural defect [of lack of receipt of a Notice of Deficiency] in a quiet title action because the purpose of a deficiency notice is to enable a challenge in the Tax Court to determine the amount of the assessment."[86]

### C. James v. United States[87]

#### 1. Facts

Ronald James was a self-styled "citizen of the Republic of Wyoming" who therefore believed he was "not a person required to file a return on I.R.S. form 1040."[88] After James ignored Notices of Deficiency mailed to him proposing assessments in respect of tax years 1981 and 1984, the Internal Revenue Service assessed a deficiency against him and proceeded to levy against his wages. James brought suit against the government under section 2410, attempting to quiet title to his wages, and protesting a variety of government actions in connection with the assessment and levy.

#### 2. Results in the District Court

James' *pro se* action raised a host of objections to the Service's assessment and levy activities, including: (1) that no valid Notice of Deficiency had been sent to him; (2) that the Service failed to lawfully assess the deficiency; (3) that the Service failed to serve a Notice of Assessment and Demand for Payment on him; and (4) that no notice of intention to levy was ever sent to him. In an opinion not officially published, the district court concluded that, fairly read, James' various challenges amounted to a suit questioning the propriety of the assessment itself — that is, the validity of the Notice of Deficiency — and in accordance with *Schmidt*, dismissed the action in its entirety.[89]

84. *Id.* at 736-737.
85. *Id.* at 737.
86. *Id.*
87. 970 F.2d 750 (10th Cir. 1992).
88. *Id.* at 754 n.8.
89. 1991-2 U.S. Tax Cas. (CCH) ¶ 50,347 (D. Wyo. 1991).

3. The Tenth Circuit's Opinion

On appeal, the Tenth Circuit Court of Appeals[90] affirmed all aspects of the district court's opinion, except that portion which dismissed James' claim that he had never been sent a notice of intent to levy for one of the years in question. Citing its very recent opinion in *Guthrie*, the court stated that section 2410 "does not waive sovereign immunity for claims that the taxpayer does not owe the taxes in question"[91] and, therefore, "does not apply to challenges surrounding notices of deficiency."[92] However, the court reiterated its conclusion in *Guthrie* that an alleged failure of the Service to correctly enter the assessment or properly send valid Notices of Assessment and Demands for Payment are procedural defects that may be challenged in a quiet title suit.[93]

The court of appeals agreed with the district court that the bulk of James' claims were not, in fact, addressed to the procedural validity of the assessment and levy process, but to the validity of the assessment itself — that is, the procedural and substantive validity of the Notice of Deficiency. In order to invoke section 2410, James had argued that the alleged invalidity of the Notice of Deficiency rendered all following assessment and levy activities infirm, and thus he was in effect challenging the latter as well as the former.[94] However, the Court of Appeals saw this argument for what it was, a "domino form of logic"[95] that was unavailing. The court stated that "the bulk of plaintiff's action is based on the merits of Mr. James' underlying tax liability, not the procedure used to notify him of the deficiency or the procedure used to collect it."[96]

In order to give James' *pro se* action the benefit of the doubt,[97] the Court of Appeals went on to discuss each of James' claims that could arguably extend to the validity of the Service's assessment and collection activities, and thus fall within the scope of a section 2410 quiet title action.[98] As to allegations that the Service failed to enter the assessment properly and failed to send James a Notice of Assessment and Demand for Payment for each of 1981 and 1984, the court simply noted that the record and evidence amply demonstrated that no such failures occurred.[99] However, the court determined that James' uncontroverted testimony that he was never sent a notice of intent to levy with respect to the levy made to satisfy the 1981 deficiency raised a genuine issue that

90. The three-judge panel was comprised of Judge Logan, Judge Barrett, and Judge Ebel.

91. James v. United States, 970 F.2d 750, 753 (10th Cir. 1992).

92. *Id.* at 755. "In any event, the record establishes that the IRS mailed notices of deficiency for both 1981 and 1984 to Mr. James." *Id.* at 755, n.10.

93. *Id.* at 53.

94. *James*, 970 F.2d at 753.

95. *Id.*

96. *Id.* at 754.

97. *Pro se* complaints are to be interpreted less stringently than those drafted by lawyers. Haines v. Kerner, 404 U.S. 519, 520 (1972).

98. *James*, 970 F.2d at 754-55.

99. *Id.* at 755.

precluded summary judgment.[100] Thus, the district court was reversed on this point and the case was remanded for a determination whether the levy for 1981 was valid.[101]

D. *Summary*

The court of appeals' opinions in *Guthrie* and *James* provide a welcome clarification and expansion of taxpayers' rights in the Tenth Circuit to challenge various phases of the assessment, collection, levy, and seizure activities of the Internal Revenue Service. It is now clear that taxpayers who for one reason or anther may have missed their opportunity to petition the Tax Court for a redetermination of their tax deficiency may nevertheless obtain injunctive relief under certain circumstances from improper government actions without having to pay the deficiency and sue for a refund. Pursuant to the statutory exception to the Anti-Injunction Act provided by section 6213, taxpayers may seek to enjoin assessment and related activities if a defect in the Notice of Deficiency giving rise to the assessment can be proved. Significantly, a taxpayer in the Tenth Circuit may seek injunctive relief under section 6213 without the need to show a lack of an adequate remedy at law. The court of appeals' view on the latter issue places it squarely in the minority, and creates a conflict among the circuits.[102]

Similarly, taxpayers may contest the following items in a quiet title action, pursuant to section 2410, without the need to demonstrate the lack of an adequate remedy at law: (1) the assessment process (including claims that the assessment was never entered or that the Notice of Assessment and Demand for Payment was not properly mailed); (2) the levy and seizure process (including a claim that the notice of intent to levy was not properly mailed, or that the seizure and sale procedures employed by the Service did not comply with statutory and regulatory requirements);[103] and (3) the validity of the government's tax lien (including claims alleging procedural and substantive defects in the lien). However, the taxpayer may not raise issues of defect in connection with the Notice of Deficiency in a quiet title action.

Taxpayers being pursued by the Internal Revenue Service are often among the persons least likely to be able to afford to pursue their rights in a refund suit brought in district court or the Claims Court. The federal government, on the other hand, enjoys virtually unlimited resources. The court's clarification of the right of taxpayers to obtain equitable relief in the described circumstances serves to somewhat level the playing field and ameliorate the significant imbalances in personal and financial resources between taxpayers and the government.

100. *Id.* at 756.
101. *Id.* at 757.
102. *See supra* note 52.
103. *See* Aqua Bar & Lounge, Inc. v. United States, 539 F.2d 935, 939 (3d Cir. 1976). For a description of the Service's internal procedures and guidelines concerning liens, levies, and sales, see IRM (CCH) Part 57(16)0 (Dec. 1992) ("Legal Reference Guide for Revenue Officers").

## III. TENTH CIRCUIT CLARIFIES REDEMPTION PERIODS APPLICABLE TO INTERNAL REVENUE SERVICE: *TITLE INSURANCE COMPANY OF MINNESOTA V. INTERNAL REVENUE SERVICE*[104]

### A. *Background*

Under the Internal Revenue Code, the United States is granted 120 days in which to redeem real property sold in foreclosure to satisfy a lien prior to the government's lien.[105] Under Colorado law, the general redemption period is only 75 days.[106] Certain notice provisions must be complied with at both the federal level[107] and at the state level[108] in connection with redemptions out of foreclosure. The interplay of these federal and Colorado redemption provisions was at issue in *Title Insurance Company of Minnesota*.[109]

### B. *Facts*

Lynn and Judith Olsen owned certain real property in Adams County, Colorado. Security Industrial Bank held a first deed of trust on this property, which was also subject to several junior tax liens, as well as a junior deed of trust in favor of Dan Savage. On April 26, 1989, Secur-

104. 963 F.2d 297 (10th Cir. 1992).

105. I.R.C. § 7425(d) (1988) provides that "[i]n the case of a sale of real property . . . to satisfy a lien prior to that of the United States, the Secretary may redeem such property within the period of 120 days from the date of such sale or the period allowable for redemption under local laws, whichever is longer."

106. COLO. REV. STAT. § 38-38-302(1) (1992 Supp.) provides as follows:

> Except as provided in this section with respect to agricultural real estate, within seventy-five days after the date of the sale of real estate by virtue of any foreclosure of a mortgage, trust deed, or other lien or by virtue of an execution and levy, the owner of the premises or any persons who might be liable upon a deficiency may redeem the premises sold by paying to the public trustee, sheriff, or other proper officer the sum for which the property was sold, with interest from the date of sale at the default rate if specified in the original instrument or if not so specified at the regular rate specified in the original instrument, together with any taxes paid or other proper charges as now provided by law, and a certificate or redemption shall be executed by the proper officer and recorded, and the public trustee, sheriff, or other public officer shall forthwith pay said money to the holder of the certificate of purchase.

COLO. REV. STAT. § 38-38-303(1) (1992 Supp.) provides in part:

> If no redemption is made within the redemption period provided for in section 38-38-302, the encumbrancer or lienor having the senior lien . . . on the sold premises . . . subsequent to the lien upon which such sale was held may redeem within ten days after the expiration of the above redemption period by paying the amount required by section 38-38-302, and each subsequent encumbrancer and lienor in succession shall have and be allowed a five-day period to redeem, according to the priority of his lien.

107. Treas. Reg. § 301.7425-4(b)(4)(ii) (1976) states as follows:

> Before the expiration of the redemption period applicable under [I.R.C. § 7425], the district director shall, in any case where a redemption is contemplated, send notice to the purchaser (or his successor in interest of record) by certified or registered mail or hand delivery of [the purchaser's] right . . . to request . . . payment in the event the right to redeem under section 7425(d) is exercised . . . for a payment made to a senior lienor.

108. COLO. REV. STAT. § 38-39-103(2) (1973) provides as follows: "No lienor or encumbrancer is entitled to redeem unless, within the [75-day] redemption period provided for in section 38-19-102, he files a notice of his intention to redeem with the public trustee, sheriff, or other officer making the sale."

109. 963 F.2d 297 (10th Cir. 1992).

ity Industrial Bank caused the property to be sold in a public trustee's sale.[110] The purchasers of the property at the public trustee's sale were Neal and Judy Goldsmith. On July 26, 1989, Savage redeemed the property from the Goldsmiths, and received a public trustee's deed on July 27, 1989.

In mid-August, 1989, Virginia Muwwakkil, a Revenue Officer of the Internal Revenue Service, telephoned Savage to advise him that the Service intended to redeem the property, and inquired about the amount of money Savage had spent in redeeming and repairing the property. Savage did not provide the requested information, nor did he appear on August 24, 1989, at a meeting scheduled by Muwwakkil at the offices of Title Insurance Company of Minnesota for the purpose of delivering a check to Savage to reimburse him for the money he had spent redeeming and repairing the property. On August 24, 1989, the 120th day after the April 26, 1989 foreclosure sale, the Service filed a certificate of redemption on the property with the office of the Adams County Clerk and Recorder. The certificate of redemption stated that the Service had tendered payment to Savage in the amount of $33,645.46 by a check dated August 23, 1989.

On August 30, 1989, the Service notified Savage of its intention to foreclose upon the property. Savage instituted proceedings in district court against the Service on September 25, 1989,[111] and then conveyed his interest in the property to Title Insurance Company of Minnesota.[112] The title company subsequently joined the action through an amended complaint, seeking an adjudication and declaration that it was the owner of the property, free and clear of any lien claimed to exist in favor of the United States. The title company asked that the government be enjoined from asserting any further claim in and to the property. Both the title company and the Service moved for summary judgment. By virtue of the action filed by Savage and joined by the title company, the validity of the certificate of redemption filed by the Service on August 24, 1989, was placed at issue.

### C. *Result in the District Court*

In a unreported decision, the district court granted the title company's motion for summary judgment, while denying the Service's motion. In so holding, the district court concluded that the Service's certificate of redemption did not comport with applicable federal and Colorado statutes, and well as applicable federal regulations.[113] As a threshold matter, the district court determined that there was no federal preemption of the Colorado redemption statutes by the federal redemp-

110. *Id.* at 298. Security Industrial Bank first provided the Internal Revenue Service with notice of the foreclosure, as required by I.R.C. § 7425(c) (1989).

111. Presumably pursuant to 28 U.S.C. § 2410 (1978), the "quiet title" statute analyzed in the *Guthrie* case, *supra* notes 60-86.

112. *Title Ins. Co.*, 963 F.2d at 299. Title Insurance Company of Minnesota had insured Savage's title to the property.

113. *Id.*

tion statutes[114] — that is, there was no *express* preemption provision contained in the federal statutes or regulations, and further, there was no *implied* preemption by federal law arising out of an "actual conflict" between state and federal law.[115] The district court went on to conclude that, in filing its certificate of redemption, the Service had not complied either with the Colorado statute that requires the Service to file a notice of intent to redeem within 75 days of the date of sale,[116] or with the Treasury Regulations[117] that require the Service to send notice of a contemplated redemption to the purchaser before the expiration of the redemption period.[118]

### D. *The Tenth Circuit's Opinion*

On appeal, the Tenth Circuit Court of Appeals affirmed the district court's grant of summary judgment, but differed with the district court's conclusions of law concerning the interplay of the federal and Colorado redemption statutes. The court of appeals first addressed the conclusions of the district court concerning the question whether the federal redemption statute preempted the Colorado redemption statute. The lower court had concluded that it saw "[n]o conflict [between the respective statutes] which would warrant application of the preemption doctrine to the state [redemption] statute."[119] However, there was some confusion as to whether the district court had actually concluded that, due to the lack of conflict, the 75 day redemption period set forth in the Colorado statute applied to the Service, and that, therefore, the Service's notice given 120 days after the foreclosure sale was untimely.[120] The court of appeals put this question to rest by noting, as the parties were forced to concede, that "it would be error if the district court had in fact held that the 75 day redemption period . . . . somehow applied to the IRS."[121] If the lower court had held that the 75 day redemption period applied to the Service, "then such would conflict with the 120 day provision in 26 U.S.C. § 7425(d) and the latter would prevail."[122] Thus, if the issue were simply "whether the 75 day period to redeem provided by the Colorado statute, or the 120 day period to redeem provided by a federal statute controls, . . . . under the Supremacy

114. Under the Supremacy Clause of the U.S. CONST. art. VI, cl. 2, federal law preempts and invalidates state law which interferes with or is contrary to federal law. *See, e.g.*, Hillsborough County, Florida v. Automated Medical Laboratories, Inc., 471 U.S. 707, 713 (1985); Gibbons v. Ogden, 9 Wheat. 1 (1824).

115. *Title Ins. Co.*, 963 F.2d at 300.

116. COLO. REV. STAT. § 38-39-203 (1992 Supp.)

117. Treas. Reg. § 301.7425-4(b)(ii) (1976).

118. *Title Ins. Co.*, 963 F.2d at 301.

119. *Id.* at 300.

120. *Id.* at 301. Part of the confusion arose over the fact that COLO. REV. STAT. 38-39-102 (1973) applies on its face to the "owner" of the foreclosed property or to any person who might be liable for a deficiency, and does not apply to a lienor. The Court of Appeals reserved judgment as to whether the Colorado statute was therefore simply not applicable to the Service.

121. *Title Ins. Co.*, 963 F.2d at 301.

122. *Id.*

Clause the federal statute would control."[123] The 120 day federal redemption period, and not the 75 day Colorado redemption period, was therefore held to apply to the Service.

The court of appeals next addressed the conclusion of the district court that the Service had not complied with the requirements of the Colorado statute stating that the redeeming party must file a notice of intent to redeem within 75 days of the foreclosure sale,[124] and having failed to file that notice, its later certificate of redemption was defective. The lower court "apparently concluded that although the IRS may have 120 days under federal law to file its certificate of redemption, under [the Colorado statute] it nonetheless had to file within 75 days" a notice of intent to redeem.[125] The court of appeals disagreed, noting that:

> [One hundred twenty] means, to us, 120 days, and a state statute . . . requiring IRS to file within 75 days a 'notice of intention' to redeem conflicts with, and impinges upon, the 120 days provided by federal statute. Under the Supremacy Clause, the federal statute preempts the state statute.[126]

The court of appeals did agree with the district court, however, in its determination that the Service had not complied with applicable Treasury Regulations[127] requiring the Service to send notice of a contemplated redemption to the purchaser before the expiration of the redemption period. On this point, the Service argued that the verbal notice given by Muwwakkil to Savage in August of 1989 satisfied the requirements of the Regulation, despite the fact that the Regulation expressly calls for notice to be given by registered or certified mail. The court of appeals disagreed, as had the district court. In view of the Service's failure to comply with the Regulation, the court of appeals held the certificate of redemption filed by the Service on August 24, 1989, to be invalid.[128]

### E. *Summary*

The opinion in *Title Insurance Company of Minnesota* lays to rest any question as to the proper redemption period applicable to the Internal Revenue Service when it seeks to redeem property which has been sold in a foreclosure sale in Colorado. The Service may rely on the 120 day redemption period provided in the Internal Revenue Code, which

123. *Id.*
124. COLO. REV. STAT. § 38-39-203 (1992 Supp.)
125. *Title Ins. Co.*, 963 F.2d at 301.
126. *Id.*
127. Treas. Reg. § 301.7425-4(b)(4)(ii) (1976).
128. *Cf.* Colorado Proprieties Acquisitions, Inc. v. United States, 894 F.2d 1173, 1174 (10th Cir. 1990), where the foreclosing lending institution gave the Service notice under I.R.C. § 7425(c)(1) by *regular* mail, not certified or registered mail as required by the statute. Despite the fact that the Service conceded it timely received the notice, the notice was held not to comply with the statute, and was, therefore, invalid. *Id.* at 1175. Comparing these facts to the situation faced in *Title Insurance Company of Minnesota* the Court of Appeals viewed *Colorado Properties Acquisitions* as a case where the "shoe was on the other foot." *Title Ins. Co.*, 963 F.2d at 302.

preempts Colorado's 75 day period. The Service also need not provide a "notice of intent to redeem," otherwise required under Colorado law to be given within 75 days of the foreclosure sale, any earlier than the 120 day period. However, *Title Insurance Company of Minnesota* points out that the courts will strictly apply the statutory and regulatory requirements imposed upon the Service in the context of redemptions. Persons seeking to challenge a redemption by the Service should carefully consider whether the Service has fully and timely complied with the regulations' requirements.[129]

## IV. Deferral of Particiaption Interest Income Did Not Clearly Reflect Income: *Resale Mobile Homes, Inc. v. Commissioner*[130]

### A. *Background*

The Internal Revenue Code provides that a taxpayer must include and report items of gross income in the taxable year in which the item is received by the taxpayer, unless under the method of accounting used by the taxpayer in computing taxable income, such item is to be properly included in some other tax year.[131] A principal method of accounting employed by many taxpayers which causes items of income to be reported in a tax year other than the year of receipt is the accrual method of accounting.[132] Under the accrual method of accounting, "income is to be included for the taxable year when all the events have occurred which fix the right to receive such income *and* the amount thereof can be determined with reasonable accuracy."[133] The foregoing is commonly known as the "all events" test. Under this two-part test, income is accrued and must be reported when (1) the taxpayer has a fixed right to receive the income and (2) the amount of the income can be determined with reasonable accuracy.[134]

With certain exceptions,[135] the taxpayer is free to choose the method of accounting that he will utilize in computing taxable income. However, if the method selected by the taxpayer does not "clearly reflect income" in application, the Internal Revenue Service is authorized to require the taxpayer to compute taxable income using a method that,

129. *See generally* Treas. Regs. § 301.7425-4 (1976).

130. 965 F.2d 818 (10th Cir. 1992).

131. I.R.C. § 451(a) (1989).

132. Treas. Reg. § 1.446-1(c)(1)(ii) (1992 amendment). The other principal method of accounting, which does generally tax items of gross income in the taxable year of receipt, is the cash receipts and disbursements method. Under the cash receipts and disbursements method of accounting, "all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received. Expenditures are to be deducted for the taxable year in which actually made." *Id.* § 1.446-1(c)(1)(i). *See also id.* §§ 1.451-1(a), 1.461-1(a)(2).

133. *Id.* § 1.446-1(c)(1)(ii) (emphasis added); *see also id.* § 1.451-1(a).

134. *See* Kent Homes, Inc. v. United States, 512 F.2d 395, 397 (10th Cir. 1975); Spring City Foundry Co. v. Commissioner, 292 U.S. 182, 184-185 (1934).

135. For example, the accrual method of accounting is *required* for all taxpayers for whom the production, purchase, or sale of merchandise is a material income-producing factor. Treas. Reg. § 1.471-1 (1989).

in the opinion of the Service, *does* clearly reflect income.[136] The foregoing principles apply not only to the overall method of accounting of the taxpayer, but also to the accounting treatment of any particular item.[137] It is well settled that the Commissioner has broad discretionary powers in determining whether the accounting method used by a taxpayer clearly reflects income, and in requiring taxpayers to switch to another method of accounting that, in the Commissioner's opinion, does clearly reflect income.[138]

In *Commissioner v. Hansen*,[139] the Supreme Court held that participation interest, held back in reserve accounts to guarantee payment of contingent liabilities, must be reported by accrual basis taxpayers in the year the paper is sold. In *Hansen*, three retail automobile and trailer dealers — accrual basis taxpayers — sold installment paper on a discounted basis to various finance companies. The finance companies held back a portion of the face value of the paper in a reserve account, as security for the payment of contingent liabilities arising out of guarantees given to the finance companies. The reserve account was credited as payments were actually made on the paper. When the balance in the reserve exceeded certain amounts, additional payments were made to the dealers. The dealers argued that the presence of the reserve arrangement prevented a conclusion that they had a present and enforceable right to the future payments, thus failing the first half of the "all events" test. The Supreme Court disagreed, holding that the taxpayers had in fact acquired a fixed right to receive the payments in the future. The fact that the taxpayer did not have a right to *presently* recover the reserve was of no consequence. All the events had occurred to fix the right to receive the payment, and only the passage of time was necessary in order for the payments to be received. Focussing on the second half of the two-part "all events" test, the dealers also argued that the amount of income could not be ascertained with reasonable accuracy. Again, the Supreme Court disagreed, stating that because the amounts in the reserve would either be paid over to the taxpayers or applied to their guarantees, the dealers would under any circumstance receive the benefit of the amounts held back. *Hansen* has been widely followed.[140]

In *Resale Mobile Homes, Inc. v. Commissioner*,[141] the Tenth Circuit was called upon to review the Commissioner's determination that the taxpayer's method of accounting for certain "participation interest" earned in the sale of consumer paper generated by its mobile home sales clearly reflected income.

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136. I.R.C. § 446(b) (1988).

137. Treas. Regs. § 1.446-1(a)(1) (1992).

138. *See* Commissioner v. Hansen, 360 U.S. 446, 467 (1959); United States v. Hughes Properties, 476 U.S. 593, 603 (1986).

139. 360 U.S. 446 (1959).

140. *See, e.g.*, Shapiro v. Commissioner, 295 F.2d 306 (9th Cir. 1961), *cert. denied*, 369 U.S. 829 (1962); General Gas Corp. v. Commissioner, 293 F.2d 35 (5th Cir. 1961), *cert. denied*, 369 U.S. 816 (1962); Morgan v. Commissioner, 277 F.2d 152 (9th Cir. 1960); Klimate Master, Inc. v. Commissioner, 42 T.C.M. (CCH) 85 (1981).

141. 965 F.2d 818 (10th Cir. 1992).

B. *Facts*

Resale Mobile Homes[142] was engaged in the sale of mobile homes in Denver, Colorado, under the name "Mobile World," and reported its income under the accrual method of accounting. Its customers often purchased mobile homes on credit, signing consumer paper that called for the payment of the amount financed over a stated period of time, in installments, with interest. The practice of Resale Mobile Homes was to immediately sell the paper to one of two finance companies, either Midland Federal Savings and Loan Association of Denver or Advance Mortgage Co., who became the servicers of the paper. Under its agreements with the finance companies, Resale Mobile Homes received the full principal amount of the consumer paper sold, and also became entitled to receive the excess of the total amount of interest scheduled to be collected from the mobile home purchaser during the life of the paper, over the total amount of interest the finance company charged the taxpayer based on a "buy rate." This excess was known as Resale Mobile Homes' "participation."

Each payment received by the finance companies was applied first to interest, based upon the actual number of days elapsed since the last payment, on a simple interest basis.[143] The reminder of the payment was applied to principal reduction. Under this method, the amount of interest accrued with respect to each payment depended solely on the date the payment was actually received by the finance company, and not on the date the payment was due. Thus, unless one were to assume that each payment would be made exactly on its due date, the amount of interest accruing under the consumer paper and the amount of Resale Mobile Homes' participation interest therein could not be exactly determined in advance.

The finance companies paid participation interest to the taxpayer over time, as they actually received the payments giving rise to the participation interest. Thus, each time a payment was received, the finance company would calculate the amount of the payment allocable to inter-

142. The company is referred to as the taxpayer throughout this discussion.

143. This method of applying payments received from the mobile home buyers was fashioned to conform to COLO. REV. STAT. § 5-2-210 (1973), as amended by the Colorado legislature on October 28, 1975, to eliminate the use of the so-called "Rule of 78's" in the event of the prepayment of a consumer loan. Under the Rule of 78's, the amount of interest allocable to each time period during the term of a loan is determined by multiplying the total interest payable over the loan term by a fraction, the numerator of which is the number of periods remaining on the loan at the time the calculation is made, and the denominator of which is the sum of all time periods during the loan term. Resale Mobile Homes, Inc. v. Commissioner, 91 T.C. 1085, 1088 n.1 (1988). The effect of this method is to cause a greater amount of interest to be allocated to the initial periods of a loan than would be the case if interest were economically accrued based on the number of days elapsed applying the stated interest rate to the then-outstanding principal balance of the loan. Because the Rule of 78's effectively and artificially retards the rate at which the principal amount of the loan is reduced, it works to the disadvantage of a consumer who desires to pay the loan off early. The 1975 amendment to COLO. REV. STAT. § 5-2-210 precludes the use of the Rule of 78's in calculating the balance due upon the prepayment of a consumer loan.

est. After then applying the buy rate to determine how much of that interest was to be retained by the fiance company, it remitted the remainder of the interest to Resale Mobile Homes.[144] On its tax returns for the years in question, Resale Mobile Homes reported the participation interest as it was actually paid over to it by the finance companies, and not as a lump sum amount at the time the paper was sold. On audit, the Commissioner determined that Resale Mobile Homes should have accrued all the participation interest in the year the consumer paper was sold, on the theory that its right to receive the interest was fixed and the amount was reasonably determinable. Resale Mobile Homes timely filed a petition for redetermination with the United States Tax Court.[145]

C. *Result in the Tax Court*

The Tax Court agreed with the Commissioner,[146] holding that the participation interest in respect of a particular piece of consumer paper should have been accrued and reported by the taxpayer in the year that the paper was sold to the finance company. As to the first prong of the two-part "all events" test, the court held that the taxpayer "acquired a fixed right to receive the participation interest when it sold the consumer paper to the finance companies. While [the taxpayer] could not compel the finance companies to immediately pay over the participation interest, such is not the key to the accrual of income."[147] The taxpayer also contended that the second half of the "all events" test was likewise not satisfied, because the amount of participation interest that would be paid by the finance companies on any particular piece of consumer paper could not be determined with reasonable accuracy. The Tax Court responded by noting that "while the word 'accuracy' means exactness or precision, when modified by the word 'reasonable' it implies something less than an exact or completely accurate amount."[148] All that is necessary is that the amount be accrued "on the basis of a reasonable estimate,"[149] and when the exact amount is determined later upon receipt,

144. The taxpayer's agreement with Advance Mortgage Co. provided that Advance had the right to maintain a "reserve account" to which the participation interest would be credited. Once the reserve account reached certain specified levels, the held-back participation interest would be paid out to the taxpayer over the life of the paper. The purpose of the "reserve account" was to provide Advance with security for the taxpayer's undertaking to repurchase any paper as to which certain warranties proved to be untrue. *Resale Mobile Homes*, 91 T.C. at 1087. The warranties included that the paper complied with federal, state, and local law; that the paper was free of set-offs, defenses, and counterclaims; and that the paper was secured by a valid first lien on the mobile home. The arrangement with Advance provided that once the amount of participation credited to the reserve account exceeded five percent of the outstanding principal amount of the paper, the excess would be payable to the taxpayer. *Id.* at 1089. The record indicated, however, that Advance never exercised its right to maintain a reserve account. *Id.* at 1087-89. No breach of warranty ever occurred. *Id.*

145. *See supra* note 9 and accompanying text.

146. *Resale Mobile Homes*, 91 T.C. at 1093.

147. *Id.* at 1094.

148. *Id.* at 1095.

149. *Id.* In fact, Resale Mobile Homes prepared estimates of the amount of participation income due under the contracts and reflected the accrued amount in income for finan-

"any difference may be included in income or deducted, as appropriate, in the year in which the correct amount is determined."[150] The Tax Court concluded that:

> [T]he amount of deferred finance income payable to [the taxpayer] was capable of *reasonable* estimation at the time of sale of the new consumer paper. The amount of such income could be calculated through amortization tables. . . . We recognize that there my be some variation in the final amounts received by [taxpayer] due to the default of purchasers or other prepayment of the paper. However, this factor alone does not prevent [taxpayer] from accruing the amount estimated. . . . We do not believe that any variance in amount, due to periodic or late payments, would be of such significance as to prevent [taxpayer] from making a reasonable estimate of the amount to be received or that any errors in such estimation would stand incapable of correction in a later year.[151]

D. *The Tenth Circuit's Opinion*

On appeal, the Tenth Circuit Court of Appeals affirmed the determination of the Tax Court.[152] In addressing the first half of the "all events" test, Resale Mobile Homes attempted to distinguish its arrangements with Midland Federal Savings and Loan Association of Denver and Advance Mortgage Co. from the arrangements present in *Hansen* and its progeny. Specifically, the taxpayer argued that in those cases, funds were actually paid into reserve accounts, and the dealers were assured of receiving the money in the reserve funds once they reached a certain level. Resale Mobile Homes contrasted that arrangement with the one employed in the present case, where no payments were made into a reserve account, and the taxpayer would not be contractually entitled to receive any participation interest until the mobile home purchasers actually made payments on the consumer paper. The purchasers' monthly payments were thus argued to be conditions precedent to any right on the part of Resale Mobile Homes to receive any participation interest.

The Tax Court had disposed of this argument by noting that the present arrangement, which reflected a "holding back" of the participation interest until it was actually received by the finance companies, was simply an economic equivalent of the reserve fund approach, and served the same purpose of ensuring that no interest was paid back to the dealer until the finance company was assured of payment.[153] The Tenth Circuit agreed with this analysis, concluding that the presence or absence of reserve accounts made no difference to the outcome.[154] While

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cial accounting purposes. The estimates were based upon amortization schedules that assumed all required monthly payments would be made as scheduled. *Id.*

150. *Id.*

151. *Id.*

152. Resale Mobile Homes, Inc. v. Commissioner, 965 F.2d 818 (10th Cir. 1992).

153. *Resale Mobile Homes*, 91 T.C. at 1094.

154. The taxpayer had argued that, although the documents gave Advance Mortgage

the court acknowledged that the taxpayer was required to wait for payment until the finance companies received payment from the mobile home purchasers, this merely created a technical "condition precedent," and in substance the arrangement "is no different from . . . agreements with reserve accounts; [the taxpayer] still will receive participation interest less any amount of interest not actually paid due to prepayment or default."[155] This delay "in reality is an issue of timing and does not make the payment of participation interest less certain or genuinely conditional."[156]

The Tenth Circuit noted that although the exact amounts ultimately paid over to Resale Mobile Homes might vary based upon the timing of receipts by the finance companies, as well as prepayments and defaults, this was no different from the economic effect of the arrangement in *Hansen*. The Court of Appeals thus agreed with the Tax Court that the first half of the "all events" test was satisfied, because:

> [The taxpayer's] right to receive participation interest was firmly established upon sale of the consumer paper to a finance company. The finance company was legally obligated to pay the participation interest to [taxpayer] when it bought the consumer paper. Although the duty of the finance company to make payment was deferred until it received payment from the purchasers, both the mobile home purchasers and the finance companies were obligated to make their respective payments. [The taxpayer] was not required to take any additional action in order to receive the participation interest.[157]

Turning to the second prong of the "all events" test, the Tenth Circuit again agreed with the Tax Court, concluding that the participation interest was susceptible of determination with reasonable accuracy. The court acknowledged that the amount of participation interest on each contract might "vary based on whether mobile home purchasers make their monthly payments on time, early, or late" and that "[c]ertainly

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Co. the option of establishing reserve accounts, Advance never did so, thus taking this case outside the scope of *Hansen*. The Tenth Circuit noted that the presence or absence of reserve accounts "is of no moment" because the "reserve accounts are simply bookkeeping entries, and '[o]n questions concerning the taxability of income, we are to be guided by facts and not by bookkeeping entries.' " *Resale Mobile Homes*, 965 F.2d at 823 (quoting Commissioner v. North Jersey Title Ins. Co., 79 F.2d 492, 493 (3d Cir. 1935)). In any event, the fact that Advance never exercised the right to require the reserve account was "evidence that operation without reserve accounts was in substance no different from operating with reserve accounts from [the taxpayer's] point of view." *Id.*

155. *Id.* at 824. Prior to the tax years in question, the taxpayer and the finance companies had operated under agreements that called for the establishment of reserve accounts, but did not contain any provision for the monthly calculation of participation interest in the manner called for under the current agreements. The prior agreements had been replaced by the current versions in response to the new restrictions placed on the use of the Rule of 78's under Colorado law, see *supra* note 140. During the years that the prior versions of the agreements were in place, Resale Mobile Homes had accrued the participation interest and reported it in its entirely in the year the consumer paper was sold to a finance company, in accordance with *Hansen*.

156. *Resale Mobile Homes*, 965 F.2d at 824.

157. *Id.* at 823.

some payments will be early and others late."[158] However, "on the aggregate [the taxpayer] should be able to reasonably estimate interest amounts in advance."[159]

The Tenth Circuit thus affirmed the Tax Court's conclusion that the "all events" test was satisfied, and that the Commissioner could require Resale Mobile Homes to accrue and currently report all participation interest due over the life of the consumer paper in the year the paper was sold to a finance company. The Commissioner was, therefore, found to be correct it his determination that the procedure used by Resale Mobile Homes to report the participation interest did not "clearly reflect income," and more specifically, that such procedure was an improper application of the accrual method of accounting.

### E. *Summary*

The decision in *Resale Mobile Homes* represents yet another example of the courts' willingness to elevate substance over form when attempting to classify transactions for federal income tax purposes. Although there were indeed some differences in the finance company agreements present in *Resale Mobile Homes* and those in *Hansen*, the differences were properly seen to be merely of a technical nature, and not cause for drawing a distinction between the two. *Resale Mobile Homes* is also reflective of the great deference that is paid by the courts to the Commissioner in reviewing determinations by the Commissioner in the tax accounting area. As noted, the Commissioner has broad discretion in determining that an accounting method used by a taxpayer does not "clearly reflect income" or has otherwise been improperly applied,[160] and these determinations are widely honored by the courts.

## V. PAYMENTS MADE IN THE CONTEXT OF A CHAPTER 11 REORGANIZATION ARE "INVOLUNTARY" AND CAN BE APPLIED BY THE INTERNAL REVENUE SERVICE AS IT MAY SEE FIT: *IN RE FULLMER*[161]

### A. *Background*

It has for some time been the position and practice of the Internal Revenue Service that when a taxpayer makes a "voluntary" payment on a tax liability, the taxpayer may designate how he wants the payment to be applied.[162] The courts agree that a taxpayer can direct how voluntary payments are to be applied.[163] When the payment is "involuntary," however, or if the taxpayer fails to designate how the payment is to be

158. *Id.*
159. *Id.*
160. *See supra* text accompanying note 137.
161. 962 F.2d 1463 (10th Cir. 1992).
162. *See* Rev. Rul. 79-284, 1979-2 C.B. 83.
163. Wood v. United States, 808 F.2d 411, 416 (5th Cir. 1987); O'Dell v. United States, 326 F.2d 451 (10th Cir. 1964).

applied, the Service will allocate the payment as it chooses.[164] In distinguishing between voluntary and involuntary tax payments, the Tax Court, in *Amos v. Commissioner*,[165] described an involuntary payment as "any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor."[166]

Whether or not payments made by a debtor in the context of a Chapter 11 bankruptcy reorganization are to be considered voluntary or involuntary is a question that has not received a consistent response from the courts. The question usually arises in response to attempts by debtors to designate class seven[167] tax payments, first, to the "trust fund" portion of employment taxes, and then to other taxes, including the "non-trust fund" portion of employment taxes.

Employment taxes generally fall into one of two categories, "trust fund" taxes and "non-trust fund" taxes. Amounts withheld by an employer from an employee's wages, such as the employee's withheld income taxes and the employee's share of social security taxes, are considered to be held by the employer in trust for the government pending their payment over to the Internal Revenue Service.[168] Such taxes are generally referred to as the trust fund portion of employment

164. Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983).

165. 47 T.C. 65 (1966)

166. *Id.* at 69.

167. The priority of certain federal tax liabilities under the Bankruptcy Code may be briefly summarized as follows:

A taxpayer's *prepetition* federal income tax liability is afforded class seven priority in the distribution of the bankruptcy estate if (i) the liability arose in respect of a taxable year that ended on or before the date of the filing of the petition, and the last due date of the return for such year occurred not more that three years immediately before the petition date, (ii) the claim is for a tax assessed within 240 days before the filing date of the petition, with enlargements of that time if an offer in compromise was pending, or (iii) the claim is for certain nondischargeable taxes not assessed prior to the commencement of the case, but still assessable. 11 U.S.C. § 507(a)(7)(A) (1988). Also afforded class seven priority are taxes required to be collected or withheld and paid over, and employment taxes on prepetition compensation earned from the debtor for which a return is last due after three years before the petition filing date. *Id.* §§ 507(a)(7)(C) and (D). Penalties relating to any of the foregoing which compensate for an actual pecuniary loss also receive class seven priority. *Id.* § 507(a)(7)(G).

Claims for *postpetition* federal income taxes incurred by the estate during the period of administration are asserted through a request for payment of administrative expenses. They share the priority afforded to administrative expenses generally, which are entitled to class one priority in the distribution of the estate. *Id.* §§ 503(b)(1) and 507(a)(1). Prepetition taxes, and prepetition taxes only, are excluded from class one priority by virtue of having been relegated to class seven priority. United States v. Redmond, 36 B.R. 932 (Bankr. D. Kan. 1984). Penalties accruing on postpetition debt may also be asserted against the estate as a class one priority. 11 U.S.C. § 503(b)(1)(C). Likewise, interest accruing on such debt receives class one priority. United States v. Cranshaw (*In re* Allied Mechanical Serv., Inc.), 885 F.2d 837, 839 (11th Cir. 1989); United States v. Ledlin (*In re* Mark Anthony Constr., Inc.), 886 F.2d 1101, 1105-06 (9th Cir. 1989); United States v. Friendship College, Inc., 737 F.2d 430, 433 (4th Cir. 1984).

Tax liabilities incurred following confirmation of the plan of reorganization are those of the debtor, not the bankruptcy estate, and generally are not affected by the bankruptcy filing.

168. I.R.C. § 7501(a) (1992).

taxes.[169] The employer's matching share of social security taxes, as well as federal unemployment taxes, constitute the non-trust fund portion.

When a corporation fails to pay its trust fund taxes, the United States Treasury suffers the loss, because the employees from whose wages the amounts were withheld nevertheless are credited in full for the withheld amounts even though they are not paid over to the government. To remedy this situation, section 6672 of the Internal Revenue Code provides that persons who are required to collect, truthfully account for, and pay over any tax — such as the trust fund portion of employment taxes — and who willfully fail to do so, are liable to the government for the full amount of the amounts not collected, accounted for, or paid over.[170] The people determined to be those required to collect, truthfully account for, and pay over the taxes are referred to as "responsible persons." The section 6672 penalty, also known as the "100 percent penalty,"[171] is frequently asserted by the Service when withheld trust fund taxes are left unpaid by a corporation. The penalty is usually assessed against officers, directors, and shareholders of a corporate employer, plus others with check-signing authority.

Voluntary payments made by an employer and designated to be applied to the trust fund portion of employment taxes will be so applied by the Service. However, where the payment is involuntary, or where the taxpayer otherwise fails to request a specific allocation, the Service will allocate employment tax payments to the non-trust fund portion that it would otherwise never collect.[172] This way, the Service maximizes the likelihood that the overall employment tax liability will be satisfied, as the Service remains free to pursue the principals of the corporation for the trust fund portion, in the form of the 100 percent penalty.[173]

As noted, a corporate debtor that is the subject of a Chapter 11 reorganization under the Bankruptcy Code will often attempt to propose a plan of reorganization that, among other things, seeks to apply its class seven tax payments first to the trust fund portion of employment taxes, and then to the non-trust fund portion and other taxes. Its goal in proposing this allocation is to maximize the amount of trust fund taxes

169. Slodov v. United States, 436 U.S. 238, 242-43 (1978).

170. I.R.C. § 6672 (1988).

171. Although these exactions are frequently termed a penalty, such description "does not alter their essential character as taxes." United States v. Sotelo, 436 U.S. 268, 275 (1978).

172. "Once the corporation is out of business, the United States can kiss goodbye any non-trust fund taxes owed it but not paid." United States v. Schroeder, 900 F.2d 1144, 1146 (7th Cir. 1990).

173. It has been held that the pendency of a corporate bankruptcy does not prevent the Service from pursuing the principals of the corporate debtor to collect the 100 percent penalty, as the latter is a "separate and distinct" obligation. United States v. Huckabee Auto Co., 783 F.2d 1546, 1548 (11th Cir. 1986). However, the courts are in disagreement as to whether the Bankruptcy Court has jurisdiction to determine the section 6672 liability of the principals of a corporate debtor, when they themselves are not "debtors" in the bankruptcy. *Compare In re* Brandt-Airflex Corp, 843 F.2d 90 (2d Cir. 1988) *and Huckabee*, 783 F.2d at 1546 *with* Quattrone Accountants, Inc. v. Internal Revenue Service, 895 F.2d 921 (3d Cir. 1990).

that would be paid off in the bankruptcy proceeding for which the debtor's principals might be held personally liable under section 6672 if the reorganization proves unsuccessful.[174]

The questions whether the Bankruptcy Court has equitable jurisdiction to confirm a plan that provides for such an allocation,[175] and whether the debtor otherwise has the right to request such an allocation, have deeply divided the courts. The reported opinions reveal the courts to be in complete disagreement over several important issues bearing on the question, including: (1) whether a Chapter 11 reorganization is "a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor;"[176] (2) a proper resolution of the conflicting interests of the "fresh start" policy manifested in the Bankruptcy Code, the tax collection goals reflected in the Internal Revenue Code, and the need to protect innocent creditors; and (3) identifying the "realities of bankruptcy" that impact the question.

Several courts have held tax payments made in the context of a Chapter 11 reorganization to be involuntary. In *In the Matter of Ribs-R-Us, Inc.*,[177] the corporate debtor filed a proposed Chapter 11 plan of reorganization providing that the government's class seven priority tax claims would be paid in full over the statutory maximum six-year period.[178] The plan further provided that all payments in class seven would be applied first to reduce the trust fund portion of the debtor's employment taxes. The Bankruptcy Court confirmed the plan over the government's objection that such payments were involuntary and could be applied by the Service in any manner the Service determined. The Bankruptcy Court disagreed with the government, holding the payments to be voluntary. The district court, relying on the Eleventh Circuit's decision in *In re A & B Heating & Air Conditioning*,[179] affirmed. As discussed

174. The corporate debtor may not obtain a discharge for unpaid trust fund employment taxes. Such taxes are class seven priority obligations, 11 U.S.C. § 507(a)(7)(C) (1988), which are not dischargeable in proceedings under Chapter 11 of the Bankruptcy Code, *id.* § 523(a)(1)(A). The non-trust portion is nondischargeable as well, if the return was last due, including extensions, after three years before the date of the bankruptcy petition. Also nondischargeable are (1) taxes entitled to class two priority (so-called "involuntary gap" claims), *id.*; (2) tax debts with respect to which a return was never filed, *id.* § 523(a)(1)(B)(i); (3) tax debts with respect to which a return was field late, and within two years of the petition, *id.* § 523(a)(1)(B)(ii); and (4) taxes as to which the debtor made a fraudulent return or willfully attempted to evade or defeat the tax, *id.* § 523(a)(1)(C). Penalties that accrue on nondischargeable federal income tax obligations are also nondischargeable. *See id.* § 523(a)(7). Interest on nondischargeable tax obligations is likewise nondischargeable. Bruning v. United States, 376 U.S. 358, 360 (1964); Allen v. Romero, 535 F.2d 618, 623 (10th Cir. 1976).

175. Under the Bankruptcy Code, the Bankruptcy Court is empowered to confirm a plan of reorganization that "include[s] any . . . appropriate provision not inconsistent with the applicable provisions of" the Bankruptcy Code. 11 U.S.C. § 1123(b)(5). *See also id.* § 1129. More generally, the court is empowered to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. *Id.* § 105(a). *See also id.* § 505 (1988 and Supp. III 1992) (granting the Bankruptcy Court the power to determine the validity and amount of taxes).

176. *See supra* text accompanying notes 167-68.

177. 828 F.2d 199 (3d Cir. 1987).

178. 11 U.S.C. § 1129(a)(9)(C) (1988).

179. 823 F.2d 462 (11th Cir. 1987), *vacated and remanded*, 486 U.S. 1002 (1988).

below, the Eleventh Circuit in *A & B Heating & Air Conditioning* held that the allocation question is one best left to judicial determination on a case-by-case basis. On appeal in *Ribs-R-Us*, the Third Circuit reversed the district court, specifically breaking with the Eleventh Circuit and holding that the payments were involuntary. In doing so, the Third Circuit stated its strong preference that the question be determined strictly as "a question of law rather than an issue for the exercise of discretion. A uniform federal rule is preferable so that debtors, creditors, and the Internal Revenue Service will be able to know in advance whether the debtor can make such a designation and guide their decisions accordingly."[180]

The debtor in *Ribs-R-Us* had argued that payments made in the Chapter 11 setting do not fall within the scope of the payments described in the *Amos* definition,[181] in view of the flexibility afforded to reorganizing debtors to propose and implement the amount and timing of payments. The Third Circuit disagreed, holding that, given the broad powers granted to the Bankruptcy Court over the debtor in a Chapter 11 bankruptcy and considering that once a plan of reorganization is confirmed the debtor operates under an express judicial order, the *Amos* standard was met.[182]

The Third Circuit in *Ribs-R-Us* viewed any contrary holding as "inconsistent with the realities of bankruptcy."[183] That reality, according to the Third Circuit, is that:

> [d]ebtors who file under *any* chapter of the bankruptcy code have few, if any, options. As a practical matter, they file bankruptcy because it is a last chance for a relatively ordered financial liquidation or rehabilitation rather that the out-of-control financial debacle facing them on the eve of bankruptcy.[184]

Finally, the debtor in *Ribs-R-Us* argued that certain provisions of the

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180. *Ribs-R-Us*, 828 F.2d at 202. The debtor argued that the success of the reorganization depended on the participation of two of the corporation's principals, who would not be willing to make a proposed cash infusion into the debtor if the trust fund taxes were not extinguished. In response, the Third Circuit pointed out that since the classification of the payment was being determined as a matter of law, the court's decision did not "depend upon whether a particular reorganization could have been effected without permitting the debtor to designate taxes. In any event, the proposed reorganization plan was not contingent upon the court's approval of the designation." *Id.* at 204.

181. Amos v. Commissioner, 47 T.C. 65, 69 (1966). *See supra* text accompanying notes 165-66.

182. *See also In Re* Frost, 47 B.R. 961, 965 (Bankr. D. Kan. 1985):

> In order to determine whether a payment to the IRS is voluntary or involuntary, it must be determined whether or not the payment was received through court or administrative action which resulted in an actual seizure of the property or money. The instant bankruptcy proceeding filed by the debtors is a legal action in which the IRS has filed a claim for delinquent taxes. The payments to be made by the debtors are under the bankruptcy court's jurisdiction and are made pursuant to a plan which must comply with the requirements of the bankruptcy code. Thus, we conclude that payments made by the debtors to the IRS are not voluntary and the IRS has the right to allocate the payments as it sees fit.

183. *Ribs-R-Us*, 828 F.2d at 203.

184. *Id.* at 203 (quoting *In re* Technical Knockout Graphics, Inc., 68 B.R. 463, 469 (Bankr. 9th Cir. 1986) (Volinn, Bankr. J., dissenting)).

Bankruptcy Code evince congressional intent as "essentially subordinat[ing] the federal policy for protection of the revenue [as set forth in 26 U.S.C. § 6672] to the competing federal policy of promoting successful Chapter 11 reorganizations."[185] Discerning no support in the legislative history for this contention, and finding no *specific* authority in the Bankruptcy Code for directing payments in a way that would contravene the policy underlying section 6672, the Third Circuit disagreed.

In *In re Technical Knockout Graphics, Inc.*,[186] prior to filing a Chapter 11 plan of reorganization, the debtor filed a motion seeking permission to make payments to the Service designated to be in reduction of its trust fund liability. The debtor "readily acknowledge[d] that by designating application of the payments first to the trust fund portion of its liability, it [was] attempting to reduce the personal liability of its responsible persons" under section 6672.[187] The government opposed the motion. The Bankruptcy Court granted the motion, and the bankruptcy appellate panel affirmed in a split decision.[188] The government appealed to the Ninth Circuit. In the meantime, the debtor had paid the trust fund portion in full and the plan had been confirmed.

On appeal, the Ninth Circuit acknowledged that "[f]ederal courts have struggled with the voluntary/involuntary distinction in the bankruptcy context and have come to different conclusions."[189] The court went on to reverse the bankruptcy appellate panel, holding that "payments made by a debtor-in-possession after filing a petition for reorganization under Chapter 11, but prior to confirmation of a reorganization plan, are involuntary and the bankruptcy court does not have equitable jurisdiction to order otherwise."[190] The debtor first argued that a bankruptcy proceeding is not the kind of "legal proceeding" contemplated by the *Amos* standard, in that the payments were not due to any enforced collection procedures or the participation of the government in the bankruptcy proceedings. The Ninth Circuit disagreed. After reviewing various provisions of the Bankruptcy Code highlighting the extent of the court's involvement and the nature of the protections afforded to the debtor in a Chapter 11 reorganization, the court concluded that:

> by filing a bankruptcy petition under Chapter 11, TKO used the authority of the court to keep its creditors at bay while it reorganized and regained financial stability. TKO is not free to abuse this system by designating its payments in a way that benefits only its responsible persons, and possibly harms other creditors, including the IRS, without the scrutiny of the court or other creditors.[191]

The debtor also argued that the equity jurisdiction of the Bank-

185. *Id.* at 203.
186. 833 F.2d 797 (9th Cir. 1987).
187. *Id.* at 801.
188. *In re* Technical Knockout Graphics, Inc., 68 B.R. 463 (Bankr. 9th Cir. 1986). *See Ribs-R-Us*, 828 F.2d at 203.
189. *Technical Knockout*, 68 B.R. at 801-02 (footnote omitted).
190. *Id.* at 802.
191. *Id.* at 803.

ruptcy Court authorized it to order that payments be applied first to the trust fund taxes.[192] Again, the Ninth Circuit disagreed, noting that, to the extent that the Bankruptcy Court's order rested on its equitable jurisdiction, "[s]uch a decision is not within the bankruptcy court's equitable jurisdiction" and to allow the bankruptcy court to designate how payments are to be applied as between trust fund and non-trust fund taxes without notice to creditors or court approval "would subvert the Bankruptcy Code."[193] The court thus held that "the IRS is entitled to apply TKO's payments as the IRS sees fit" to preserve the right of the IRS to pursue the responsible persons under section 6672.[194]

Under facts similar to those present in *Ribs-R-Us*, the Bankruptcy Court in *DuCharmes & Co. v. Michigan (In re DuCharmes & Co.)*,[195] confirmed the debtor's Chapter 11 plan of reorganization only after striking out provisions that would have allocated payments first to trust fund taxes. The district court reversed, holding that such payments were voluntary and could be allocated any way the debtor preferred. On appeal, the Sixth Circuit reversed the district court, stating in a brief opinion that "we agree with the Third and Ninth Circuits that payments made to the IRS on pre-petition tax liabilities by a Chapter 11 debtor ought to be considered 'involuntary payments' that may not be allocated to pay the debtor's trust fund liabilities first."[196]

Other courts have held tax payments made in the context of a Chapter 11 proceeding to be voluntary. In *In re A & B Heating & Air Conditioning*,[197] the corporate debtor had proposed a Chapter 11 plan of reorganization that provided for payment of the debtor's federal tax liability over the statutory six-year period, with payments to be first applied to trust fund taxes. It was recognized that "[b]y paying off the trust fund taxes, the corporate president and sole shareholder would be relieved of his separate liability under [section 6672] for these trust fund taxes."[198] The plan was confirmed by the Bankruptcy Court, over the government's objection.[199] The district court affirmed. On appeal, the Elev-

192. The Ninth Circuit pointed out that, in fact, the bankruptcy court had not specifically ordered the Service to apply the payments to the trust fund liability, but rather to apply the payments as the debtor requested. *Id.*

193. *Id.*

194. *Id.*

195. 852 F.2d 194 (6th Cir. 1988).

196. *Id.* at 196.

197. 823 F.2d 462 (11th Cir. 1987), *vacated and remanded for consideration of mootness question*, 486 U.S. 1002 (1988).

198. *Id.* at 463.

199. *In re* A & B Heating & Air Conditioning, 53 B.R. 54 (Bankr. S.D. Fla. 1985). The bankruptcy court stated:

> Court involvement in the context of a Chapter 11 reorganization case is not the type which results in seizure of property or money as in a levy. Unlike a taxpayer faced with a government instituted collection proceeding which may lead ultimately to levy upon the taxpayer's assets, a Chapter 11 debtor enjoys a great latitude in how and if a plan is proposed and thus how and when the IRS will be paid. . . . The debtor propounding a plan has a number of options with respect to treatment of a claim by the IRS and it is the freedom afforded by theses options which dictates the conclusion that payments to the IRS pursuant to a confirmed Chapter 11 plan of reorganization are voluntary.

enth Circuit Court of Appeals affirmed in turn, holding that "the allocation question in a Chapter 11 case . . . should be left to judicial discretion to be decided on a case-by-case basis."[200]

The Eleventh Circuit acknowledged the conflicting results of prior decisions, describing them as:

> [A] direct result of the conflicting policies behind the Bankruptcy Code and the Internal Revenue Code. On the one hand, Congress, by enacting [section 6672,] intended to impose liability upon corporate officers who allow trust fund taxes to be used for any purpose other that the payment of withheld taxes.
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> . . . .
>
> On the other hand, Congress has enacted a detailed Bankruptcy Code which sets forth an orderly process by which creditors of a bankrupt entity are entitled to be repaid. In doing so, Congress "has provided bankrupts with extensive protection from their creditors and a reasonable opportunity for rehabilitation not only for their benefit but for that of the public as well." . . . The Code expresses a preference toward reorganization rather then liquidation; a viable reorganization plan typically provides greater payment to creditors while preserving the economic life of the entity.[201]

The Eleventh Circuit found the policy of the Bankruptcy Code to outweigh that of the Internal Revenue Code. That policy, in turn, was undermined by classifying the tax payments as involuntary, which in many cases would be "detrimental to the reorganization plan" because the incentive of the corporate officers to support the plan would be reduced, and "[f]requently, the efforts put forth by these officers during the reorganization is the corporation's only hope for future viability."[202] The Eleventh Circuit concluded that "[p]ermitting the Internal Revenue Service to allocate tax payments in *all* Chapter 11 proceedings runs contrary to" the policies underlying the Bankruptcy Code, and "decline[d] to accept that argument of the IRS that *all* payments made under a Chapter 11 reorganization are involuntary and thus property allocated by the IRS."[203]

Rather than hold the tax payments to be voluntary as a matter of

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*Id.* at 57.

200. *In re A & B Heating & Air Conditioning*, 823 F.2d at 465, (quoting *In re* B & P Enterprises, Inc., 67 B.R. 179, 183 (Bankr. W.D. Tenn. 1986)).

201. *Id.* at 464-65 (citation omitted).

202. *Id.* at 465. Citing to a law review article, the court noted that:

> If corporate officers are pressured to pay the taxes out of their own pockets, the incentive to continue successful reorganization is reduced, and it becomes more likely that the responsible officers will convert to Chapter 7 liquidation. Under Chapter 7, as in Chapter 11, taxes have priority; the government will be paid in full whether sufficient funds remain for other unsecured creditors or not. The responsible officers are guaranteed that no tax penalty will be assessed against them personally.

*Id.* (quoting Note, *Bankruptcy Court Jurisdiction and the Power to Enjoin the IRS*, 70 MINN. L. REV. 1279, 1299-1300 (1986)).

203. *Id.* (emphasis added).

law, however, the Eleventh Circuit relied on the equitable jurisdiction of the Bankruptcy Court and held that the allocation question "should be left to judicial discretion to be decided on a case-by-case basis."[204] The court of appeals remanded to the district court "with directions that the bankruptcy court weigh the impact the proposed allocation would have upon the debtor, Internal Revenue Service, and other creditors."[205]

In *In re Lifescape, Inc.*,[206] the Bankruptcy Court for the District of Colorado held employment tax payments made in a Chapter 11 reorganization to be voluntary, concluding that "[t]he fact that payments are made pursuant to a plan which must comply with the requirements of the Bankruptcy Code does not rise to the level of court action equivalent to a levy, judicial order, execution or judicial sale" implicating the *Amos* definition.[207]

In *United States v. Energy Resources Co.*,[208] the question of whether the Bankruptcy Court has the equitable power and jurisdiction to order that payments made under a proposed Chapter 11 plan of reorganization be allocated against the trust fund portion came before the Supreme Court. The case actually consisted of two separate debtors whose appeals were consolidated by the court of appeals. In one of the cases, a plan of reorganization was confirmed by the Bankruptcy Court over the government's objection, providing that tax payments would be applied to extinguish all trust fund taxes prior to the commencement of payment of the non-trust fund portion. The district court affirmed. In the other case, the Service refused to comply with the debtor's request to apply a post-confirmation payment to the trust fund portion. In response, the debtor obtained an order from the Bankruptcy Court directing the Service to so apply the payment. The district court reversed, holding that the Bankruptcy Court did not have the power to do so.

On appeal, the First Circuit Court of Appeals consolidated the cases and accepted the government's contention that the tax payments were involuntary.[209] However, the Court of Appeals went on to hold that, *notwithstanding* the classification of the payments as involuntary, the

204. *Id.* (quoting *In re* B & P Enterprises, Inc., 67 B.R. 179, 183 (Bankr. W.D. Tenn. 1986)). Relying in large part on factors set out in *B & P Enterprises*, the Eleventh Circuit stated that the Bankruptcy Court is to consider the "equitable reasons warranting such allocations" and should look to the history of the debtor; the absence or existence of prebankruptcy collection or enforced collection measures of the Service against the corporation and "responsible persons;" the nature and contents of the Chapter 11 plan (e.g., whether it is a reorganization or a last resort liquidation); the presence, extent, and nature of administrative and/or court action; the presence of pre- or post-bankruptcy agreements between the debtor and the Service; and the existence of exceptional or special circumstances or equitable reasons warranting the allocation. *See B & P Enterprises, Inc.*, 67 B.R. at 184. "Most importantly, the bankruptcy judge should consider whether the proposed plan is merely a stop gap scheme to hold the taxing authorities at bay with little chance that the debtor will fulfill its obligation under the plan." *A & B Heating & Air Conditioning*, 823 F.2d at 466.

205. *A & B Heating & Air Conditioning*, 823 F.2d at 466.

206. 54 B.R. 526 (Bankr. D. Colo. 1985).

207. *Id.* at 529.

208. 495 U.S. 545 (1990).

209. *In re* Energy Resources Co., Inc., 871 F.2d 223 (1st Cir. 1989).

Bankruptcy Court had the authority to order the Service to apply such payments to the trust fund portion of employment taxes if the Bankruptcy Court concluded that this designation was necessary to ensure the success of the reorganization.[210] The First Circuit thus struck a position consistent with that of the Eleventh Circuit, but opposed to that of the Third, Sixth, and Ninth Circuits. Noting this conflict, the Supreme Court granted certiori. The Supreme Court then affirmed the First Circuit Court of Appeals in a brief opinion authored by Mr. Justice White.

After observing that several provisions of the Bankruptcy Code[211] "are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships,"[212] the Supreme Court addressed the government's contention that other provisions of the Bankruptcy Code reflect a policy that the Service be paid in full as to the debtor's tax liabilities, and thus impose limitations on the Bankruptcy Court's equity power that had been exceeded in these cases.[213] The government argued that if payments can be allocated first to the trust fund portion, it would be "at risk" for the non-trust fund portions, which cannot be recovered from the responsible persons.[214] On the other hand, if the Service is allowed to apply tax payments to the non-trust fund portion first, it stands a better chance of collecting the entire amount owed because the debt that is not "guaranteed" by responsible persons in the form of the section 6672 penalty will be paid off before the guaranteed portion. The Supreme Court responded by stating that:

> [w]hile this result might be desirable from the Government's standpoint, it is an added protection not specified in the [Bankruptcy] Code itself: whereas the Code gives it the right to be assured that its taxes will be paid in six years, the Government wants an assurance that its taxes will be paid even if the reorganization fails — *i.e.*, even if the bankruptcy court is incorrect in its judgment that the reorganization plan will succeed.[215]

The Supreme Court further noted that the order of the Bankruptcy Court causing payments to be first applied to the trust fund portion does not remove section 6672 from the field of play: "As the Government concedes, § 6672 remains both during and after the corporate Chapter 11 filing as an alternative collection source for trust fund taxes."[216] The Supreme Court thus held that the Bankruptcy Court "may order the IRS to apply tax payments to offset trust fund obligations where it concludes

210. *Id.* at 234.

211. *See supra* note 174.

212. *Energy Resources Co.*, 495 U.S. at 551.

213. The government noted that the Bankruptcy Code affords class seven priority status to the tax claims at issue, see *supra* note 167, and makes them nondischargeable, see *supra* note 173. Moreover, the Bankruptcy Court is required to assure itself that the reorganization plan will succeed, 11 U.S.C. § 1129(a)(11), and therefore, that the Service will in all likelihood collect the tax debt owned. *Energy Resources Co.*, 495 U. S. at 551.

214. *Energy Resources Co.*, 495 U.S. at 551.

215. *Id.* at 549.

216. *Id.* at 551.

that this action is necessary for a reorganization's success."[217]

B. *Facts*

In *In re Fullmer*,[218] the Internal Revenue Service had filed a proof of claim in the taxpayer's Chapter 11 reorganization proceeding. After confirmation of the plan of reorganization, the taxpayer paid the Service the amount of the claim, apparently designating the payment to be applied to his postpetition tax obligations rather than his prepetition tax debt. The Service refused to honor this designation, and applied the payments to the prepetition debt. The Bankruptcy Court sided with the Service, and the district court affirmed.

C. *The Tenth Circuit's Opinion*

On appeal, the Tenth Circuit opted to join the Third,[219] Sixth,[220] and Ninth Circuits[221] and held that payments made by a debtor pursuant to a Chapter 11 proceeding are involuntary. In its brief discussion of the issue, the Tenth Circuit concluded that "[t]o interpret such payments otherwise would be inconsistent with the realities of bankruptcy where a debtor is required to make such payments pursuant to an express judicial order. Thus, we conclude that Mr. Fullmer was not entitled to direct the application of his payments to any particular tax liability."[222] The Service was, therefore, free to apply the payment as it saw fit.

D. *Summary*

Although not arising in the context of a dispute over employment taxes, the *Fullmer* decision would seem to have equal applicability to a debtor's attempts to designate payments against the trust fund portion of employment taxes to which the "100 percent penalty" imposed under section 6672 applies, particularly since the Tenth Circuit, in reaching its decision, relied entirely on the previously discussed cases arising under section 6672 that were decided by the Third, Sixth, and Ninth Circuits. However, the decision of the Supreme Court in *Energy Resources Co.*[223] seems clearly to cast doubt on the rationales expressed by the Third, Sixth, and Ninth Circuits in support of their respective conclusions, and renders those opinions somewhat doubtful authority.

It is to be kept in mind, however, that the Supreme Court in *United States v. Energy Resources Co.* never reached the question of whether a Chapter 11 debtor's tax payments are properly characterized as voluntary or involuntary. There remains a split among the circuits on this

217. *Id.*
218. 962 F.2d 1463 (10th Cir. 1992).
219. *See supra* note 177.
220. *See supra* note 195.
221. *See supra* note 186.
222. *In re Fullmer*, 962 F.2d at 1468.
223. 495 U.S. 545 (1990).

question, with the Third, Sixth, Ninth, and Tenth Circuits viewing such payments as involuntary, and the First and Eleventh Circuits viewing them as voluntary. The Supreme Court *did* hold that the Bankruptcy Court has the power in the exercise of its equitable jurisdiction under the Bankruptcy Code to order that tax payments are to first be applied to the trust fund portion of employment taxes, and to confirm a plan of reorganization that so provides, even if the payments are properly considered involuntary. To the extent that a Chapter 11 debtor in the Tenth Circuit attempts to designate the application of tax payments without the aid of a court order or an express provision in the plan of reorganization supporting such an application, *Fullmer* indicates that the debtor will not be successful. Given the decision of the Tenth Circuit in *Fullmer*, Chapter 11 debtors are well advised to propose plans of reorganization that provide specifically for the allocation of class seven tax payments, first, to the trust fund portion of the debtor's employment tax liability, so as to maximize the possibility that the debtor's "responsible persons" will not find themselves personally liable for the trust fund portion. Payments made outside the context of a confirmed plan of reorganization should be supported by a court order specifying this allocation, if the debtor is still under the jurisdiction of the Bankruptcy Court.

In light of the fact that the Bankruptcy Court will issue orders or confirm plans of reorganizations calling for such a designation of tax payments only in the discretionary exercise of its equitable powers, Chapter 11 debtors in the Tenth Circuit must be prepared to demonstrate that such exercise of equitable jurisdiction is justified under this circumstances. It is likely that factors such as those discussed by the Eleventh Circuit in *In re A & B Heating & Air Conditioning* will influence the Bankruptcy Court's determination.[224] It remains to be seen how much flexibility will be afforded debtors in the Tenth Circuit in proposing allocations of their tax payments.

## VI. Summary of Other Cases Decided by the Tenth Circuit in 1992

### A. *Some Decisions of Note*

In *Hall v. United States*,[225] the Tenth Circuit ruled that the mitigation provisions of I.R.C. §§ 1311-1314 apply only in the context of the federal income tax, and therefore do not apply to the windfall profit tax.[226] The taxpayers owned a five percent overriding royalty interest in a federal oil and gas lease in Wyoming being operated by Amoco Production Company. In 1986, the Bureau of Land Management of the Department of the Interior reduced the number of the participating acres in the area,

224. *See supra* note 204.

225. 975 F.2d 722 (10th Cir. 1992).

226. The windfall profit tax was set out in I.R.C. §§ 4986 to 4990 prior to its repeal in 1988. *See* § 1941 of the Omnibus Trade and Competition Act of 1988, Pub. L. No. 100-418, 102 Stat. 1107, 1322 (1988).

the effect of which was to reduce the Hall's net revenue interest to 1.923 percent. The reduction of participating acres was made retroactive to 1976. Amoco unilaterally recouped from the Halls the amount of excess royalty payments made to the Halls prior to 1986 based upon the reduction in participating acres, and issued "corrected" Forms 6248, Annual Information Return of Windfall Profit Tax, to the Halls for 1980 thorough 1985. These forms, of course, indicated that as a result of the reduction of participating acres and the Halls' interest therein, the Halls had overpaid their windfall profit tax for each of those years. The taxpayers successfully filed tax refund claims with the Service for each of the years 1983 through 1985. However, as to the years 1980 through 1982, the Service disallowed the Halls' refund claim on the ground that they were barred by the applicable statute of limitations.[227] The Halls, understandably aggrieved at the resulting "whip-saw" being worked upon them by two branches of the federal government, brought suit in district court seeking to invoke the mitigation provisions of sections 1311-1314.[228] The district court allowed the claim, and entered judgment for the Halls in the amount of $72,300. On appeal, however, the Tenth Circuit reversed, concluding that the mitigation provisions do not apply to the windfall profit tax. The court noted that sections 1311-1314, the mitigation provisions, are found in *Subtitle A* of Title 26, U.S.C., which relates solely to *income* taxes. On the other hand, prior to their repeal the windfall profit tax provisions were found in *Subtitle D* of Title 26, U.S.C., which relates to "Miscellaneous Excise Taxes." After reviewing the legislative history of the mitigation provisions, the Tenth Circuit agreed with the government that these relief provisions could not be invoked by the Halls. The *Hall* decision thus puts the Tenth Circuit on record as limiting the mitigation provisions of sections 1311-1314 to the income tax sphere.[229]

In *Pottorf v. United States*,[230] the plaintiffs were shareholders in Pot-

227. I.R.C. § 6511(a) (1988) requires tax refund claims to be filed within two years of the payment of the tax or within three years from the filing of the relevant return, whichever is later.

228. Briefly summarized, the provisions of I.R.C. §§ 1311-1314 are aimed at mitigating the harsh effect of applicable statutes of limitation by recognizing that certain determinations relating to a tax year, such as court determinations or final dispositions of refund claims, may create "errors" such as the double inclusion or exclusion of income or the double allowance or disallowance of deductions or credits in time-barred years. For example, a Tax Court determination that a particular item of income is includable in a given "open" year may create an accounting "error" if the taxpayer had actually included it in a prior "closed" year and paid tax on it. The mitigation provisions of I.R.C. §§ 1311-1314 allow for a correction of the error through certain prescribed adjustments, despite the fact that the prior year is closed by the statute of limitations.

229. *But see* Chertkof v. United States, 676 F.2d 984 (4th Cir. 1982). In *Chertkof*, the Fourth Circuit invoked the mitigation provisions of § 1311-1314 to avoid a taxpayer whipsaw that had both income tax and estate tax implications. *See also* the dissent filed in *Hall* by Judge Garnett Thomas Eisele, Senior District Judge for the District of Arkansas sitting by designation, voicing agreement with the "well-reasoned opinion of the district court in this case" and the reasoning in *Chertkof*. *Hall*, 975 F.2d at 727.

230. Nos. 91-3365, 91-3366, 1992 U.S. App. LEXIS 32797 (10th Cir. Dec. 2, 1992). The decision is reflected in an unpublished Order and Judgement. Such Order has no precedential value and may not be cited or used by any court within the Tenth Circuit,

torf Farms, Inc., a Kansas corporation that forfeited its Articles of Incorporation when it failed to pay applicable state franchise taxes. Following the forfeiture, the Internal Revenue Service filed notices of tax liens against the corporation's real property in the local real property records. When the real property was subsequently condemned, the IRS successfully claimed the condemnation proceeds in a state court proceeding. In this appeal, the shareholders of Pottorf Farms, Inc., argued that once the corporation had lost its charter, title to the corporation's property passed by operation of law to the shareholders, and thus, the IRS's later-filed lien was invalid. The Tenth Circuit Court of Appeals pointed out, however, that under Kansas state law[231] a corporation may continue to act for three years following its dissolution for the purpose of winding up its affairs. Although the corporation had forfeited its Articles of Incorporation, it continued to exist as an entity for the purposes of paying its debts and disposing of its assets. The condemnation proceeds were therefore determined to be the property of the corporation, not the shareholders, and the IRS's lien was held valid.

B. *Bankruptcy*

In *In re Bates*,[232] the debtor filed a Chapter 13 bankruptcy petition. The debtor had owned and operated a Wyoming lumber business as a sole proprietorship. It was determined that the debtor owed the government $61,212.89 in federal employment taxes. Of this amount, $39,714.72 were "trust fund" taxes and $21,498.17 were "non-trust fund" taxes.[233] The IRS perfected its general tax lien[234] for these amounts by filing prepetition notices of lien. The value of debtor's assets available to satisfy this lien amounted to $21,950, leaving the government unsecured as to most of the debt.[235] The debtor presented a Chapter 13 plan that proposed to classify the unpaid trust fund portion as a class two priority claim that would be paid in full, and to classify the remaining, non-trust fund portion as an unsecured claim that would be paid pennies on the dollar. The debtor's presumed goal in proposing this classification was to obtain a discharge for most of the non-trust fund portion. On appeal, the Tenth Circuit affirmed the district court's determination that the trust fund portion was to be classified as a secured claim, and that the non-trust fund portion was to be classified as a class seven priority claim.[236] Due to the fact that priority tax claims in bankruptcy are not dischargeable,[237] the effect of the court's classifica-

except for purposes of establishing the doctrines of law of the case, res judicata, or collateral estoppel. 10th CIR. R. 36.3.

231. KAN. STAT. ANN. § 17-6807 (1988).

232. 974 F.2d 1234 (10th Cir. 1992).

233. *See generally* the discussion of the *Fullmer* case which appears *supra* notes 218-22.

234. *See supra* note 39 and accompanying text.

235. 11 U.S.C. § 506(a) (1988) provides that a claim secured by a lien on property is considered "secured" to the extent of the value of the property, and "unsecured" to the extent the amount of the creditor's interest exceeds the value of the property.

236. *See supra* note 168.

237. *See supra* note 174.

tion was to deny debtor a discharge for any portion of the employment taxes.

In *In re Cassidy, Jr.*,[238] the Tenth Circuit held that the ten percent penalty imposed under I.R.C. § 72(t) on premature withdrawals from pension plans, profit sharing plans, and IRA's[239] is not to be afforded priority under the Bankruptcy Code.[240] The first question addressed by the court was whether the ten percent exaction was a "tax" that could be afforded class seven priority.[241] The court acknowledged that the ten percent exaction is in fact labelled a "tax" under the Internal Revenue Code, but concluded that "Congress' labelling of the section 72(t) exaction as a tax is not determinative of its status for priority in bankruptcy."[242] The court then went on to hold that, in view of the ambiguous legislative history of section 72(t)[243] and the acknowledged purpose of the Bankruptcy Code provisions relating to priorities,[244] the ten percent exaction is properly characterized as a penalty and not a tax, and is not to be afforded priority.[245] The court further concluded that the penalty was not entitled to class seven priority as "compensation for actual pecuniary loss."[246]

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238. 983 F.2d 161 (10th Cir. 1992).

239. I.R.C. § 72(t) (1988).

240. The question whether the 10 percent penalty is dischargeable in bankruptcy is left open. If the penalty is not determined to be imposed in connection with a tax that is nondischargeable, or if the withdrawal occurred more than three years prior to the date of the bankruptcy petition, the penalty would be dischargeable. *See* 11 U.S.C. § 523(a)(7) (1988).

241. 11 U.S.C. § 507(a)(7) (1988) states as follows:

(a) The following expenses and claims have priority in the following order:

. . . .

(7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for —

(A) a tax on or measure by income or gross receipts.

242. *Cassidy, Jr.*, 983 F.2d at 163. This conclusion places the Tenth Circuit in apparent conflict with the Sixth Circuit, which has indicated its inclination to defer to Congress' designation of a "tax" as such under the Internal Revenue Code. *Id*; *see also* United States v. Mansfield Tire & Rubber Co., 942 F.2d 1055 (6th Cir. 1991).

243. A "tax" has been judicially defined to mean (1) an involuntary pecuniary burden, regardless of name, laid upon individual or property; (2) imposed by, or under authority of the legislature; (3) for public purposes, including the purposes of defraying expenses of government or undertakings authorized by it; (4) under the police or taxing power of the state." *In re* Lorber Industries of California, Inc., 675 F.2d 1062, 1066 (9th Cir. 1982). The Tenth Circuit viewed the application of the third test as problematic. On the one hand, it is possible to divine a "public purpose" underlying section 72(t), in that the exaction could be argued to recapture a measure of tax benefits afforded under the qualified retirement plan rules, and to promote savings. However, the legislative history of section 72(t) was equally susceptible of being read to indicate that the purpose of section 72(t) was simply to penalize early withdrawals. *Cassdy, Jr.*, 983 F.2d at 164.

244. This purpose of allowing priority claims is to compensate for a pecuniary loss actually suffered, and not to afford priority to claims not reflecting a pecuniary loss, as the latter would have the effect of depleting rather than conserving the bankruptcy estate and punish innocent creditors. *See* Matter of Unified Control Systems, Inc., 586 F.2d 1036, 1038 (5th Cir. 1979).

245. *Cassidy, Jr.*, 983 F.2d at 165.

246. *Id.* 11 U.S.C § 507(a)(7)(G) provides class seven priority for any "penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss."

C. *Tax Shelters*

In *Jackson v. Commissioner*,[247] *Nickeson v. Commissioner*,[248] and *Cannon v. Commissioner*,[249] taxpayers were denied deductions for losses incurred in tax shelter transactions found by the Tax Court[250] to have been entered into without a profit motive.[251] In *Jackson*, the taxpayer purchased "territorial distributorships" from U.S. Distributors, Inc., entitling them to distribute the jewelry products of American Gold & Diamond Corporation within designated territories. Based upon their initial investment of $15,000, and the fact that the Jacksons had executed documents obligating them to pay $720,000 on a nonrecourse basis for territorial distribution rights, the Jacksons were encouraged by the tax shelter promoter to deduct $60,000 on their 1982 federal income tax return. Believing the arrangement to be an abusive tax shelter, the Jackson's accountant refused to file the return on this basis, and instead deducted only the Jackson's 1982 out-of-pocket expenditures incurred in acquiring the distribution rights. Relying heavily upon its 1985 opinion in *Moore v. Commissioner*[252] involving the identical tax shelter arrangement, the Tax Court concluded that the arrangement was so lacking in economic substance as to be a sham, and disallowed this deduction.[253] On appeal, the Tenth Circuit agreed with the Tax Court "that the transaction was a sham and that the Jacksons are not entitled to their claimed deductions."[254] Noting that either lack of a profit motive or lack of economic substance can render a transaction a sham,[255] the Tenth Circuit found that various factors supported this conclusion, such as the lack of operating history of the promoting entities and their lack of goodwill, the emphasis placed by the operative documents on the tax benefits represented to be available, the unrealistic financing arrangement, and the fact that there was no demonstrated source of product. As to the profit motive of the taxpayers, the Tenth Circuit determined that the Tax Court was justified in finding that the taxpayers had no genuine expectation of profit, particularly considering the fact that the contract assigned unspecified territories to them[256] and the fact that the Jacksons made no

247. 966 F.2d 598 (10th Cir. 1992).

248. 962 F.2d 973 (10th Cir. 1992).

249. 949 F.2d 345 (10th Cir. 1991).

250. Jackson v. Commissioner, 61 T.C.M. (CCH) 2806 (1991); Cannon v. Commissioner, 59 T.C.M. (CCH) 164 (1990); Brock v. Commissioner, 58 T.C.M. (CCH) 826 (1989), *aff'd sub nom.* Nickeson v. Commissioner, 962 F.2d 973 (10th Cir. 1992).

251. Whether a taxpayer enters into a transaction in pursuit of economic profit is a question of fact. The trial court's findings on that issue are not to be disturbed on appeal unless they are "clearly erroneous." FED. R. CIV. P. 52(a). The Supreme Court has instructed that: "[a] finding is "clearly erroneous" when although there is evidence to support it, the reviewing court on the entire evidence is left with a definite and firm conviction that the mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948).

252. 85 T.C. 72 (1985).

253. *Jackson*, 161 T.C.M. (CCH) at 2810.

254. *Jackson*, 966 F.2d at 601.

255. *See* Bohrer v. Commissioner, 945 F.2d 344, 348 n.5 (10th Cir. 1991); Casebeer v. Commissioner, 909 F.2d 1360, 1363 (9th Cir. 1990).

256. *Jackson*, 966 F.2d at 601. The territories were assigned on a lottery basis after the

attempt to research the industry or the companies.

The *Jackson* court cited *Nickeson* as support for its conclusions.[257] In *Nickeson*, the Tax Court had disallowed the taxpayers' deductions under I.R.C. § 174(a) (1988) for research and development expenses incurred in developing an automatic meter reading device.[258] The taxpayers had deducted the amount of money and the face amount of certain promissory notes delivered to George Risk, the promoter of the arrangement and a principal of George Risk Industries, Inc, of Kimball, Nebraska. The offering documents stressed the tax benefits of participating in the arrangement, which included a touted 4-to-1 write-off based on the initial cash investment, but gave no particulars concerning the manner in which the technology was to be developed or any other economic aspects of the project. Recognizing that a taxpayer's entitlement to deductions under section 174 depends upon whether the taxpayer is engaged in a "trade or business,"[259] the Tenth Circuit acknowledged that this required an "initial inquiry into whether the 'activity was undertaken or continued' in good faith, with the dominant hope and intent of realizing a profit, *i.e.*, taxable income, therefrom."[260] Applying various tests, including the nine factors listed in the "hobby loss" regulations under I.R.C. § 183[261] and the so-called *Rose* test,[262] and after reviewing past decisions evaluating the presence or absence of profit motive in research and development programs and related activities,[263] the Tenth Circuit concluded that the taxpayers "did not meet their burden to show they entered the . . . program with a good faith intent to profit; rather, the [arrangement] was 'the naked sale of tax benefits.' "[264]

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investment was made, and the taxpayers seemed unconcerned about which territories were assigned to them. *Id.*

257. *Id.* See also Kubler v. Commissioner, No 90-9019, 1992 U.S. App. LEXIS (10th. Cir. April 24, 1992) (*Nickeson* reasoning applied to deny deductions under I.R.C. § 174 for development of components of variable opacity glass.) The Order and Judgment in *Kubler* was unpublished, *see supra* note 219.

258. Nickeson v. Commissioner, 962 F.2d 973 (10th Cir. 1992).

259. I.R.C. § 174 (1988) allows the taxpayer to deduct "research or experimental expenditures which are paid or incurred by him during the taxable year *in connection with his trade or business as expenses*." *Id.* (emphasis added).

260. *Nickeson*, 962 F.2d at 976 (citations omitted).

261. I.R.C. § 183 (1988) precludes the deduction of so-called "hobby losses," that is, activities "not engaged in for profit." Treas. Reg. § 1.183-2(b) (1972) outlines nine factors indicative of a good faith intent on the part of the taxpayer to recognize a profit. Paraphrased, the factors are (1) the extent to which the taxpayer carries on the activity in a businesslike manner, (2) the taxpayer's expertise or his reliance on the advice of experts, (3) the time and effort the taxpayer expends in carrying on the activity, (4) the expectation that assets used in the activity may appreciate in value, (5) the taxpayer's success in similar activities, (6) the taxpayer's history of income or loss in the activity, (7) the amount of occasional profits, if any, (8) the taxpayer's financial status, and (9) the elements of personal pleasure or recreation. *Id.*

262. In Rose v. Commissioner, 88 T.C. 386 (1987), *aff'd*, 868 F.2d 851 (6th Cir. 1989), the Tax Court developed a two-step "generic tax shelter" and "economic substance" test to determine the validity of deductions and credits derived from activities where the tax benefit requires that the taxpayer's activities constitute either a trade or business or be undertaken for the production of income, as required by I.R.C. § 162 & 212 (1988).

263. *Nickeson*, 962 F.2d at 977.

264. *Id.* at 977-978 (quoting Brock v. Commissioner, 58 T.C.M. (CCH) 836 (1989)).

Finally, in *Cannon v. Commissioner*,[265] the taxpayer had invested over $800,000 in a Mexican gold and silver mining venture that never turned a profit. The Tax Court agreed with the Commissioner[266] that the expenditures were nondeductible under section 183.[267] On appeal, the Tenth Circuit Court of Appeals[268] reviewed the application of the nine hobby loss factors[269] to the taxpayer's investment activities in Mexico. While it concluded that some of the factors supported the taxpayer and others supported the government, "[t]aking all facts and circumstances into account, we cannot say that the Tax Court's application of the [factors listed in the] Treasury Regulations accompanying section 183 was clearly erroneous."[270]

D. *Enforcement*

In *Long v. United States*,[271] the Tenth Circuit held that the Service did not unlawfully disclose tax information concerning the taxpayers by sending notices of liens and levies to various financial institutions, county recorders, the Colorado Department of Revenue, and the Social Security Administration in an effort to collect a $138,961 jeopardy assessment[272] against the taxpayers. The taxpayer had filed this action against the Service claiming damages arising from the disclosures.[273] The Tenth Circuit held that disclosures made to the Colorado Department of Revenue were statutorily authorized[274] under the Service's written Agreement on Coordination of Tax Administration.[275] Despite the

265. 59 T.C.M. (CCH) 164 (1990), *aff'd*, 949 F.2d 345 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 3030 (1992).

266. *Id.*

267. *Id.* at 170. On appeal, the taxpayer objected to the invocation of I.R.C. § 183 by the Tax Court, because that section had not been explicitly raised or considered by the Service or the taxpayer. According to the taxpayer, only sections 162, 212 and 616 were at issue and had been raised by the parties. The Tenth Circuit disagreed, concluding that section 183 "is interrelated to sections 162 and 212, profit motive being the common underlying theme." Cannon v. Commissioner, 949 F.2d 345, 348 (10th Cir. 1991). "In determining whether the mining activity met the requirements of sections 162 or 212, the court naturally applied section 183. Section 183 is often used in analyzing 'for profit' issues, both in the context of hobby losses and in the context of trade or business expenses." *Id.* Thus, "the Tax Court's application of section 183 was routine and predictable, not extraordinary." *Id.* at 349.

268. *Cannon*, 949 F.2d at 352.

269. *See supra* note 261.

270. *Cannon*, 949 F.2d at 352.

271. 972 F.2d 1174 (10th Cir. 1992).

272. *See* I.R.C. § 6861(a) (1988).

273. I.R.C. § 7431(a)(1) (1988) provides that "[i]f any officer or employee of the United States knowingly, or by reason of negligence, discloses any return or return information with respect to a taxpayer . . . such taxpayer may bring a civil action for damages against the Untied States in a district court of the United States." The confidentiality of return information is protected by I.R.C § 6103(a) (1988).

274. I.R.C. § 6103(d)(1) (1988) authorizes disclosures by the Service to state agencies if certain conditions are satisfied, including that the disclosure be made "only upon written request" of the agency, and only "to the representatives of such agency . . . designated in such written request." *Id.*

275. The IRS has entered into Agreements on Coordination of Tax Administration with each of the fifty states and the District of Columbia. The Agreement is in standard form, and prides, *inter alia*, that "[t]his agreement constitutes the requisite authorization

taxpayer's arguments to the contrary,[276] the court further held that disclosures to financial institutions, county recorders, and the Social Security Administration were clearly authorized under the Internal Revenue Code[277] and the Income Tax Regulations.[278]

In *Diandre v. United States*,[279] the district court held that a Special Agent of the Criminal Investigation Division of the Internal Revenue Service improperly disclosed tax return information concerning the taxpayer and his business. The agent had sent a "circular letter" to the business' banks and customers requesting information concerning transactions between the business and the recipients of the letter. The letter informed the banks and customers that the Service was investigating the taxpayer and the business, and disclosed certain information about the taxpayer, such as his name, address, and status as a director of the company.[280] As a result of the information obtained, summons were subsequently issued to all the banks. The district court held that the information was disclosed in violation of I.R.C. § 6103.[281] On appeal, the Tenth Circuit Court of Appeals reversed the determination of the district court. The major area of disagreement between the parties was

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pursuant to § 6103(d)(1) of the Code for IRS to disclose to, and permit inspection by, an agency representative of Federal returns and Federal return information." *Long*, 972 F.2d at 1178.

276. The taxpayer's arguments essentially amounted to a challenge to the sufficiency of the assessment, and not to the disclosure procedures. The Service produced a certified copy of Form 4340, "Certificate of Assessment and Payments," which was acknowledged by the Tenth Circuit to be "sufficient evidence that an assessment was made in the manner prescribed by § 6203 and Treas. Reg. 301.6203-1," which establish the applicable statutory and regulatory requirements. *Long*, 972 F.2d at 1181. *See supra* note 65.

277. Under I.R.C. § 6103(k)(6) (1988), tax return information may be disclosed in the course of an investigation if three requirements are met: (1) the information sought is "with respect to the correct determination of tax, liability for tax or the amount to be collected, or with respect to the enforcement of another provision" of the Internal Revenue Code, (2) the information sought is "not otherwise reasonably available," and (3) it is necessary to make disclosures of return information in order to obtain the additional information sought.

278. Treas. Reg. § 301.6103(k)(6)-(1)(b)(6) (1980) authorizes disclosures of tax return information when necessary to "establish or verify the financial status or condition and location of the taxpayer whom collection is or may be directed, [and] to locate assets in which the taxpayer has an interest" in connection with "the establishment of liens against . . . assets [in which the taxpayer has an interest], or levy on, or seizure, or sale of, the assets to satisfy [the taxpayer's tax] liability."

279. 968 F.2d 1049 (10th Cir. 1992).

280. The letter stated:

> The Internal Revenue Service is conducting an investigation of Metro Denver Maintenance, Inc., Lakewood, Colorado, for the years 1983 through 1985. Mr. DiAndrea is an officer of Metro Denver Maintenance whose address is 6800 West 6th Avenue, Lakewood, Colorado, 80215.
>
> During the course of our investigation, we noted transactions between you and Metro Denver Maintenance, Inc. and/or Mr. DiAndrea for [the] previously mentioned period. As part of our investigation, we need to verify the purpose of these transactions. Your assistance is needed in determining all payments made to or on behalf of Metro Denver Maintenance, Inc. and/or Mr. DiAndrea for the previously mentioned period. We would appreciate you furnishing the information indicated on Attachment 1, for use in a Federal tax matter.

*Id.* at 1051. The Attachment referred to "the date, check number, amount and form of all payment(s) . . . made in cash, money order, etc." The Attachment specifically referred to "payments made in the form of cash." *Id.*

281. *See supra* notes 273-78.

whether the requirement of section 6103 that the information be "not otherwise reasonably available" had been satisfied. The court of appeals held that, because the letter requested information about possible cash payments made by the recipients to the taxpayer or his business, and because this information could not reasonably be obtained from any other source, the statutory requirement was met. The court of appeals also admonished that "[t]he district court strayed beyond the parameters of section 6103 when it sought to determine [the agent's] subjective intent and when it concluded that insufficient justification was shown to warrant delving into whether cash payments were made."[282] The court of appeals noted that:

> section 6103 does not provide a vehicle to test the probable cause or any other level of justification to investigate. . . . The plain language of section 6103 does not limit in any way what information the IRS may seek in the course of an investigation. Section 6103 merely imposes certain restriction on the IRS's ability to make disclosures in seeking that information.[283]

In *United States v. Dawes,*[284] the Tenth Circuit joined the Sixth[285] and Ninth[286] Circuits, as well as several district courts,[287] in holding that a taxpayer's conviction for failure to file federal income tax returns is not precluded by the fact that the Treasury Regulations and the instructions accompanying the tax forms do not carry an Office of Management and Budget[288] control number.[289] Donald and Phyllis Dawes had each pled guilty to three counts of willful failure to file federal income tax returns[290] for 1981, 1982, and 1983, but preserved for appeal the question whether the lack of OMB control numbers excused their failure to file. Relying on the reasoning of the other courts that previ-

282. *DiAndrea*, 968 F.2d at 1053.

283. *Id.*; *see* Barrett v. United States, 795 F.2d 446, 451 (5th Cir. 1986) ("the court does *not* inquire whether the information sought is necessary"); United States v. MacKay, 608 F.2d 830, 832 (10th Cir. 1979) (stating that the Service is not required to have probable cause to issue a summons). On the other hand, the Service must use its summons authority in good faith, and the courts may refuse to enforce a summons if it was issued to harass the taxpayer or if it is unclear or overly broad. United States v. LaSalle National Bank, 437 U.S. 298, 313 (1978); United States v. Powell, 379 U.S. 48, 57 (1964); United States v. Malnik, 489 F.2d 682, 686 n.4 (5th Cir.), *cert. denied*, 419 U.S. 826 (1974).

284. 951 F.2d 1189 (10th Cir. 1991).

285. United States v. Wunder, 919 F.2d 34, 38 (6th Cir. 1990).

286. United States v. Hicks, 947 F.2d 1356, 1358-60 (9th Cir. 1991).

287. *See* United States v. Stiner, 765 F. Supp. 663 (D. Kan. 1991); United States v. Burdett, 768 F. Supp. 409 (E.D.N.Y. 1991); Brewer v. United States, 764 F. Supp. 309 (S.D.N.Y. 1991); United States v. Crocker, 753 F. Supp. 1209, 1214-16 (D. Del. 1991).

288. Hereinafter referred to as the "OMB."

289. Under the Paperwork Reduction Act of 1980, Pub. L. No. 96-511, 94 Stat. 2812 (1980), the OMB is assigned the task to review all federal forms constituting "information collection requests," 44 U.S.C. § 3507 (1988), and assignment of a control number to all forms approved by the OMB. Under the Paperwork Reduction Act, 44 U.S.C. § 3512, "no person shall be subject to any penalty for failing to maintain or provide information to any agency if the information collection request . . . does not display a current control number assigned" by the OMB. The taxpayers had argued that because the Income Tax Regulations and the instructions do not contain OMB control numbers, they could not be penalized for failing to file their income tax returns.

290. *See* I.R.C. § 7203 (1988).

ously addressed the issue,[291] the Tenth Circuit concluded that this argument was without merit.[292]

In *United States v. Gosnell*,[293] the taxpayer transferred all his assets to a purported business trust. The Tenth Circuit determined that "the District Court properly ordered the foreclosure on the government's lien after it determined that the transfer was fraudulent,"[294] and rejected various tax protest claims.[295]

### E. *Annual Round-up of Tax Protestors, and Other Matters*

During 1992, the Tenth Circuit Court of Appeals disposed of various tax protestor cases and other matters in a similar vein. These are summarized in the following paragraphs.

In *Fox v. Commissioner*,[296] the court affirmed the dismissal of a Tax Court petition filed by a tax protestor who claimed "that she was 'brainwashed' by one Sy Prog, apparently a tax protestor, into proceeding before the Tax Court in the manner she did,"[297] and now wanted a "second chance to produce evidence in the Tax Court."[298]

In *Pleasant v. Lovell*,[299] members of the National Commodity and Barter Association, a national tax protest organization,[300] sued certain

291. The analysis of each of the courts that has previously addressed the issue has varied, but all the courts have come to the same conclusion. The reasoning has included that the requirement to file a tax return is mandated by statute, not regulation, so the taxpayer was not convicted of violating the regulations, *see* United States v. Wunder, 919 F.2d 34, 38 (6th Cir. 1990); that the explicit statutory requirement to file a tax return places the regulations and instructions beyond the scope of the Paperwork Reduction Act of 1980, United Sates v. Hicks, 947 F.2d 1359 (9th Cir. 1991); and that the regulations and instructions cannot be viewed independently and classified as "information collection requests" as defined by the statute — they are merely subsidiary to the income tax forms, and assist taxpayers in completing the return, *Crocker*, 753 F. Supp. at 1216. The Tenth Circuit was most persuaded by the latter analysis. Form 1040, the personal income tax return form, and its associated forms do carry OMB control numbers.

292. *Dawes*, 951 F.2d 1189. Subsequent 1992 Tenth Circuit cases following *Dawes* include United States v. Jump, No. 91-5183, 1992 U.S. App. LEXIS 27779 (10th Cir. Oct. 19, 1992) and Gassei v. Dep't of Justice, No. 91-6400, 1992 U.S. App. LEXIS 15381 (10th Cir. June 25, 1992).

293. 961 F.2d 1518 (10th Cir. 1992). For other 1992 decisions by the Tenth Circuit relating to fraudulent conveyances, both decided to the same effect, *see* United States v. Jensen, No. 91-4224, 1992 U.S. App. LEXIS 34732 (10th Cir. Dec. 29, 1992) and United States v. Neilson, No. 91-4175, 1992 U.S. App. LEXIS 34823 (10th Cir. Dec. 23, 1992).

294. *Gosnell*, 961 F.2d at 1520.

295. Gosnell's appeal was determined to be frivolous, and sanctions in the amount of $1,500 were awarded to the government. *Gosnell*, 961 F.2d at 1521. *See* Casper v. Commissioner, 805 F.2d 902 (10th Cir. 1986).

296. 969 F.2d 951 (10th Cir. 1992).

297. *Id.* at 952. Fox's petition asserted various claims that the Tenth Circuit acknowledged to be "blatantly frivolous and groundless." *Id.*

298. *Id.*

299. 974 F.2d 1222 (10th Cir. 1992).

300. The National Commodity and Barter Association "is an organization formed in 1979 which 'espouses dissident views on the federal tax system and advocates a return to currency backed by gold and silver.' " United States v. National Commodity & Barter Ass'n, 1990-1 U. S. Tax Cas. (CCH) ¶ 50,284 (quoting Voss v. Bergsgaard, 774 F.2d 402, 405 (10th Cir. 1985)). The NCBA is especially active in the Tenth Circuit. The NCBA has been described as an organization whose members "advocate dissident political views concerning the tax and monetary policy of the United States Government," Kroll v. United

government agents alleging violations of the group members' First Amendment rights to free speech and freedom of association, and Fourth Amendment rights against unreasonable search and seizure.[301] The Tenth Circuit affirmed the district court's dismissal of these claims.[302]

In *Fostvedt v. United States*,[303] the Tenth Circuit affirmed the district court's reliance on the Anti-Injunction Act and the tax exception provision of the Declaratory Judgment Act[304] to dismiss a taxpayer's suit seeking to "declare the actions of the [Service] to be arbitrary, capricious, an abuse of discretion and unconstitutional, and [to] enjoin the agency from further action against"[305] him until the Service complied with his request to submit his grievances to the National Office for technical advice, abate the Notice of Deficiency, and hold an appeals conference. The taxpayer also sought a declaration that the Service violated his constitutional rights by keeping records classifying him as a tax protestor. The court viewed the taxpayer's action as "an attempt to delay and/or prevent the IRS from assessing and collecting the income tax deficiencies and penalties due because of [taxpayer's] failure to file income tax returns for the years in question."[306]

In *United States v. Parsons*,[307] an individual[308] filed false Form 1099's with the Service, reflecting that he had paid taxable compensation to various public and private officials with whom he had disagreements, in an attempt to trigger tax audits or investigations of those individuals.[309]

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States, 573 F. Supp. 982, 984 (N.D. Ind. 1983), in response to what the organization "perceives to be an unconstitutional and oppressive monetary and taxation system. The leadership of the NCBA advocates and promotes opposition to federal income tax laws." United States v. Stelten, 867 F.2d 446, 448 (8th Cir. 1989). Among other services, the National Commodity Exchange, which has been described as the "service wing" of the NCBA, is "operated by NCBA members as a private or warehouse bank" which the Service views as a vehicle designed, among other things, to obscure the paper trail surrounding the financial affairs of its members. Aspinall v. United States, 984 F.2d 355 (10th Cir. 1993) (quoting National Commodity & Barter Ass'n v. United States, 951 F.2d 1172, 1173 (10th Cir. 1991)); Heinold Hog Mkt., Inc. v. McCoy, 700 F.2d 611, 612 (10th Cir. 1983). Reported opinions involving the NCBA and its members are legion, numbering in the dozens.

301. In an earlier decision, Pleasant v. Lovell, 876 F.2d 787, 792 (10th Cir. 1989), the Tenth Circuit had reversed in part a grant of summary judgment against the plaintiffs, holding that material issues of fact existed concerning the availability of a qualified immunity defense. On remand, the district court ruled that no constitutional violations had occurred, and alternatively, that qualified immunity protected the government agents. This determination was at issue in the current appeal.

302. Parallel litigation was pursued by the NCBA. *See* National Commodity & Barter Ass'n v. Gibbs, 886 F.2d 1240 (10th Cir. 1989) (remanding to the district court on First and Fourth Amendment claims); National Commodity & Barter Ass'n v. Gibbs, 1992-2 U.S. Tax Cas. (CCH) ¶ 50,334 (D. Colo. 1991) (on remand, dismissing the action).

303. 978 F.2d 1201 (10th Cir. 1992).

304. *See supra* notes 43-44.

305. *Fostvedt*, 978 F.2d at 1202.

306. *Id.* at 1203.

307. 967 F.2d 452 (10th Cir. 1992).

308. Among other things, Parsons was a member of the National Commodity and Barter Association. *See supra* note 300.

309. For other examples of the use of this "strategy," *see* United States v. Olson, No. 91-2109, 1992 U. S. App. LEXIS 7244 (10th Cir. Apr. 14, 1992) (following her conviction

The Tenth Circuit affirmed Parson's conviction on thirteen counts of willfully making a false statement to a United States agency[310] and one count of knowingly making and presenting a false claim.[311]

In *United States v. Cutler*,[312] the taxpayer opened various stock brokerage accounts and undertook substantial trading activity using false names, phone numbers, and social security numbers. Based on the false account information, the brokerage firm prepared and filed Forms 1099-B reflecting the stock transaction information. The Tenth Circuit affirmed Cutler's felony conviction that was based on six counts of aiding and assisting in the preparation or presentation of false documents arising under the internal revenue laws.[313] In *United States v. Payne*,[314] under facts similar to those present in *Cutler*, the taxpayer's conviction for tax evasion[315] and false representation of social security numbers[316] was upheld.

In *Van Skiver v. United States*,[317] a tax protester[318] brought an action alleging wrongful levy and unauthorized disclosure of tax return information, and seeking to quiet title to personal property. After the district court dismissed the action, the Van Skivers filed a self-styled "Motion to Reconsider." Finding no support in the Federal Rules of Evidence to authorize such a motion, and finding various other defects in the motion and the taxpayers' claims, the Tenth Circuit affirmed the dismissal of the action.

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on a minor traffic matter, New Mexico resident filed false 1099's reflecting she had paid over $400,000 in taxable compensation to the municipal judge who presided at her trial and to various jail and police personnel; conviction affirmed); United States v. Hildebrandt, 961 F.2d 116 (8th Cir. 1992) (farmer filed false Form 1099's on various individuals that were connected with the bank seizure of his farm; conviction affirmed); United States v. Citrowske, 951 F.2d 899 (8th Cir. 1991) (farmer filed false Form 1099's on 36 individuals; conviction affirmed).

310. *See* 18 U.S.C. § 1001 (1988).

311. *See id.* § 287.

312. 948 F.2d 691 (10th Cir. 1991).

313. I.R.C. § 7206(2) (1988) makes it a felony to willfully aid or assist in, or procure, counsel, or advise "the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter."

314. 978 F.2d 1177 (10th Cir. 1992).

315. *See* I.R.C. § 7201 (1988).

316. *See* 42 U.S.C. § 408(a)(7)(B) (1991 Supp.).

317. 952 F.2d 1241 (10th Cir. 1991).

318. Raymond and Alma Van Skiver are no strangers to the federal courts. For an example of the bizarre tenor of the Van Skivers' views on the internal revenue laws, see United States v. Van Skiver, 1991-1 U.S. Tax Cas. (CCH) ¶ 50,017 (D. Kan. 1990).

# UNITED STATES SUPREME COURT REVIEW OF TENTH CIRCUIT DECISIONS

## INTRODUCTION

In its 1992 session, the United States Supreme Court decided seven cases originating from the Tenth Circuit.[1] This survey discusses two cases, *United States v. Williams* and *United States v. Felix*, involving important sections of the Fifth Amendment of the Constitution that will have direct impacts on prosecutorial actions and defendants' Fifth Amendment protections. Both decisions make it easier for prosecutors to bring suspects to trial. In *Williams*, the Supreme Court negated the Tenth Circuit's requirement that prosecutors present possible exculpatory evidence to the grand jury.[2] In *Felix*, the Court, again reversing the Tenth Circuit, held (1) that admission of evidence of a crime at one trial does not bar subsequent prosecution of that crime[3] and (2) that conspiracy to commit a crime and the actual crime itself are separate offenses for double jeopardy purposes.[4]

## I. *UNITED STATES V. WILLIAMS*: AN OTHERWISE VALID INDICTMENT MAY NOT BE DISMISSED SOLELY BECAUSE THE GOVERNMENT DID NOT PRESENT EXCULPATORY EVIDENCE TO THE GRAND JURY

### A. *Introduction*

The grand jury was first established in the 12th century by King Henry II, to give him a means to enforce his dealings with the state and to gain greater control over the administration of justice.[5] However, the idea of the grand jury as a protector did not develop until the late 17th century, when King Charles II tried to use the grand jury to indict the Earl of Shaftesbury and Stephen Colledge for treason. These two men were well-known Protestants who were, with popular support, trying to

1. United States v. Williams, 112 S. Ct. 1735 (1992); Barnhill v. Johnson, 112 S. Ct. 1386 (1992); United States v. Felix, 112 S. Ct. 1377 (1992) [*Felix II*]; McCarthy v. Madigan, 112 S. Ct. 1081 (1992); Arkansas v. Oklahoma, 112 S. Ct. 1046 (1992); Dewsnup v. Timm, 112 S. Ct. 773 (1992); United States v. Ibarra, 112 S. Ct. 4 (1991). For a discussion of *Arkansas v. Oklahoma*, a landmark water pollution law case, see Cynthia McNeill, Comment, *The States Square off in* Arkansas v. Oklahoma: *And the Winner Is . . . the EPA*, 70 DENV. U. L. REV. — (1993).

2. *Williams*, 112 S. Ct. at 1742.

3. *Felix II*, 112 S. Ct. at 1382. References to the Tenth Circuit disposition of this case, United States v. Felix, 926 F.2d 1522 (10th Cir. 1991), *rev'd*, 112 S. Ct. 1377 (1992), are also *Felix II*. References to United States v. Felix, 867 F.2d 1068 (8th Cir. 1989) are *Felix I*.

4. *Felix II*, 112 S. Ct. at 1383.

5. *See, e.g.*, MARVIN E. FRANKEL & GARY P. NAFTALIS, THE GRAND JURY: AN INSTITUTION ON TRIAL 6-7 (1977); Douglas P. Currier, Note, *The Exercise of Supervisory Powers to Dismiss a Grand Jury Indictment—A Basis for Curbing Prosecutorial Misconduct*, 45 OHIO ST. L.J. 1077, 1078 (1984).

prevent the King from reestablishing the Catholic Church in England. The grand jury refused to act under the King's orders and did not issue an indictment.[6] English colonists brought the concept of the grand jury to the new world. The framers of the Constitution incorporated it into the Fifth Amendment of the Bill of Rights,[7] intending that the grand jury should act as a shield against improper indictment.[8] Today, however, the grand jury acts as both a shield and a sword.[9] In the criminal justice system, the function of the grand jury is to issue indictments.[10] This function has become a powerful tool in the hands of prosecutors, a tool that has great potential for abuse because of lack of control by the courts over prosecutors' actions.[11] The lower federal courts and the Supreme Court have shown little propensity to permit judicial supervision of grand jury proceedings, fearing the generation of collateral proceedings and disruptive delaying tactics by the defense.[12] For instance, in *Bank of Nova Scotia v. United States*,[13] the Court held that federal courts may not dismiss an indictment for errors in grand jury proceedings absent a showing of prejudice to the defendant.[14] In *United States v. Williams*, the Court decided only the narrow question of whether prosecutors should present exculpatory evidence to grand juries, holding that there was no duty for prosecutors to do this.[15] However, the broader effect of *Williams* will be to functionally negate the entire idea of judicial supervision.[16]

### B. *Facts*

John H. Williams, Jr. was an investor and businessman in Tulsa, Oklahoma.[17] Between September 1984 and November 1985, Williams obtained loans and loan renewals from four banks in Tulsa. With each request for a loan or renewal, Williams provided the banks with two

6. FRANKEL & NAFTALIS, *supra* note 5, at 9; Currier, *supra* note 5, at 1078.

7. The Fifth Amendment provides in part: "No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury . . . ." U.S. CONST. amend. V.

8. Anne Bowen Poulin, *Supervision of the Grand Jury: Who Watches the Guardian?*, 68 WASH. U. L.Q. 885 (1990).

9. *Id.* at 885-86.

10. Currier, *supra* note 5, at 1078.

11. Poulin, *supra* note 8, at 886-87; Peter Arenella, *Reforming the Federal Grand Jury and the State Preliminary Hearing to Prevent Conviction Without Adjudication*, 78 MICH. L. REV. 463, 549-54, 565-69 (1980).

12. Poulin, *supra* note 8, at 887-89.

13. 487 U.S. 250 (1988).

14. *Id.* at 263. *Cf.* Midland Asphalt Corp. v. United States, 489 U.S. 794, 799 (1989) (defendant may not appeal trial court's denial of a motion to dismiss the indictment for alleged violation of Rule 6(e) of the Federal Rules of Criminal Procedure); United States v. Mechanik, 475 U.S. 66, 71 (1986) (a postconviction appeal of a violation of Rule 6(d) of the Federal Rules of Criminal Procedure must be reviewed under a harmless-error standard); United States v. Calandra, 414 U.S. 338, 351-52 (1974) (no dismissal of indictment based on illegally seized evidence because accused may challenge evidence at trial); Costello v. United States, 350 U.S. 359, 364 (1956) (no dismissal of indictment based solely on hearsay evidence). *See generally* Poulin, *supra* note 8; Currier, *supra* note 5.

15. United States v. Williams, 112 S. Ct. 1735, 1742 (1992).

16. See *infra* notes 74-80 and accompanying text.

17. *Williams*, 112 S. Ct. at 1737.

types of financial statements: a "Market Value Balance Sheet" and a "Statement of Projected Income and Expenses."[18]

The "Market Value Balance Sheet" contained a category labeled "Current Assets."[19] Williams included as current assets $5 million to $6 million in notes receivable from three venture capital companies in which he had invested. Each of the companies had a negative net worth at the time. However, Williams' financial statements carried a disclaimer that these assets were carried at cost rather than at market value.[20] The second type of financial statement, the "Statement of Projected Income and Expense," listed as a source of income the interest income payable on these notes receivable. However, it did not indicate that these interest payments were entirely funded by Williams' own loans to the venture capital companies.[21]

In May 1988, after a six-month investigation, a federal grand jury indicted Williams on seven counts of knowingly making false statements or reports for the purpose of influencing the actions of a federally insured financial institution,[22] in violation of the Crimes and Criminal Procedures Act.[23] The indictment accused Williams of supplying the banks with "materially false" statements that willfully overvalued his current assets and interest income.[24]

Shortly after his arraignment, Williams filed a motion to compel the government to disclose any evidence that tended to exculpate him.[25] The government indicated that it would comply with its duty under *Brady v. Maryland*[26] to provide exculpatory evidence, but failed to do so. The district court then ordered the government to provide any exculpatory material. The government agreed to provide Williams with edited portions of the grand jury transcripts and to provide the unedited transcript to the court.[27]

After reviewing this material, Williams filed a motion to dismiss the indictment, claiming that the government failed to present substantial exculpatory evidence to the grand jury, citing prior Tenth Circuit precedent in *United States v. Page*.[28] In *Page*, the Tenth Circuit adopted the rule that prosecutors must reveal to the grand jury substantial exculpa-

18. *Id.*

19. The label "current assets" describes assets that will be realized in cash within one year. United States v. Williams, 899 F.2d 898, 899 (10th Cir. 1990), *rev'd*, 112 S. Ct. 1735 (1992).

20. *Williams*, 112 S. Ct. at 1737.

21. *Williams*, 898 F.2d at 899.

22. *Williams*, 112 S. Ct. at 1737.

23. 18 U.S.C. § 1014 (1988 & Supp. III 1991).

24. *Williams*, 899 F.2d at 899.

25. *Id.*

26. Brady v. Maryland, 373 U.S. 83, 87 (1963) (requiring the government to disclose evidence favorable to the accused when the evidence is material to either guilt or punishment).

27. *Williams*, 899 F.2d at 899.

28. 808 F.2d 723, 728 (10th Cir.), *cert. denied*, 482 U.S. 918 (1987) (holding that when substantial exculpatory evidence is discovered during an investigation, it must be revealed to the grand jury).

tory evidence discovered during an investigation, or risk dismissal of the indictment.[29] The rationale for adopting this rule was the promotion of judicial economy. The Tenth Circuit, in adopting this rule, chose to follow decisions of the Second and Seventh Circuits[30] rather than decisions of the Sixth, Eighth and Ninth Circuits which held that prosecutors need not present exculpatory evidence.[31] Williams argued that his financial records (consisting of ledgers, tax returns and financial statements) and his deposition from a contemporaneous Chapter 11 bankruptcy proceeding showed that his methods of accounting and financial reporting were consistent with the financial statements he had provided to the banks.[32] This evidence of consistency, Williams argued, this "exculpatory evidence," would have exonerated him. The district court denied the motion to dismiss the indictment.[33]

Williams then entered a motion to reconsider this dismissal. Upon reconsideration, the district court dismissed the grand jury indictment without prejudice. The court found that the evidence " 'raises reasonable doubt about the defendant's intent to defraud' "[34] and that the lack of this evidence "rendered the grand jury's indictment 'gravely suspect.' "[35]

### C. *The Tenth Circuit Opinion*

The issue on appeal before the Tenth Circuit was whether the government had presented all the necessary evidence required under *Page*. The government argued that "under its theory" of the case (that Williams intended to influence the banks' actions), the government had presented "all relevant evidence" to the grand jury.[36] The Tenth Circuit thoroughly discussed the district court's findings with respect to this contention. In first reviewing the district court's findings under a "clearly erroneous" standard,[37] the Tenth Circuit concluded that the district court's choice among more than one permissible view of the evidence could not be clearly erroneous.[38] The Tenth Circuit then reviewed the materials on which Williams based his argument that the government should have presented exculpatory material to the grand jury. These materials consisted of Williams' financial records and his

29. *Id.*

30. Unites States v. Flomenhoft, 714 F.2d 708 (7th Cir. 1983), *cert. denied*, 465 U.S. 1068 (1984); United States v. Ciambrone, 601 F.2d 616 (2d Cir. 1979).

31. United States v. Adamo, 742 F.2d 927 (6th Cir. 1984), *cert. denied*, 469 U.S. 1193 (1985); United States v. Sears, Roebuck & Co., 719 F.2d 1386 (9th Cir. 1983), *cert. denied*, 465 U.S. 1079 (1984); United States v. Civella, 666 F.2d 1122 (8th Cir. 1981).

32. *Williams*, 112 S. Ct. at 1737-38.

33. *Williams*, 899 F.2d at 900.

34. *Id.* (quoting the District Judge's Order).

35. *Id.*

36. *Id.* at 901.

37. *Id.* at 900. *See* United States v. Ortiz, 804 F.2d 1161, 1164 n.2 (10th Cir. 1986) (explaining that the rule of civil procedure that questions of fact are reviewed under a clearly erroneous standard may be applied to certain issues in criminal proceedings).

38. *Williams*, 899 F.2d at 900 (citing Lone Star Steel Co. v. United Mine Workers, 851 F.2d 1239, 1242 (10th Cir. 1988)).

deposition given in an earlier bankruptcy proceeding. The Tenth Circuit's goal was to determine whether the government should have presented this material to the grand jury as part of proving one of the essential elements of its case—whether Williams intended to influence the banks' action by use of false statements.[39]

The Tenth Circuit followed the district court in separating the questionable evidence into two categories: (1) the bankruptcy deposition and (2) the financial statements and tax records prepared by Williams and his accounting firm.[40] The Tenth Circuit found that although the statements Williams made in his bankruptcy depositions were "irrelevant and self-serving" under the government's theory of the case, they were not necessarily so under a different theory that the grand jury could have reasonably adopted.[41] Because there could be more than one view of this evidence, the district court's finding that the deposition contained exculpatory evidence was not clearly erroneous.[42] After examining the financial statements, the Tenth Circuit found that a grand jury could reasonably conclude that Williams had a different understanding of "current assets" than the government or the banks and that because of these different meanings, Williams did not intend to mislead the banks. The government urged the court to review the grand jury transcript, arguing that this evidence was presented to the grand jury by the testimony of its witnesses. The Tenth Circuit was unable to review the grand jury transcript, however, because the government did not designate it as part of the record.[43] The court was therefore forced to conclude that the district court's finding that the government withheld exculpatory evidence was not clearly erroneous.[44]

The Tenth Circuit then briefly discussed whether Williams was prejudiced by the failure of the government to present the exculpatory evidence and whether the district court abused its discretion by dismissing the indictment. The court found that by withholding the exculpatory evidence, the government " 'substantially influence[d]' " the grand jury's decision to indict, or at least raised a " 'grave doubt that the decision to indict was free from such substantial influence.' "[45] This met the *Bank of Nova Scotia* standard for errors that prejudice the defendant: whether the violations substantially influenced the grand jury's decision to indict.[46] These circumstances were sufficient for the Tenth Circuit to find that the district court did not abuse its discretion by dismissing the indictment.[47]

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39. *Id.* at 901.
40. *Id.* at 901-03.
41. *Id.* at 902.
42. *Id.*
43. *Id.* at 903.
44. *Id.*
45. *Id.* at 903 (quoting Bank of Nova Scotia v. United States, 487 U.S. 250, 263 (1988)).
46. *Bank of Nova Scotia*, 487 U.S. at 263.
47. *Williams*, 899 F.2d at 904.

D. *The Supreme Court Decision*

1. The Majority Opinion

Justice Scalia wrote the 5-4 opinion for the Supreme Court reversing the Tenth Circuit decision. The opinion held that district courts may not dismiss an otherwise valid indictment because the government failed to disclose substantial exculpatory evidence to the grand jury.[48] The holding extended a line of cases confirming the Court's reluctance to challenge the validity of grand jury indictments and curtailing judicial supervision of grand juries.[49]

The Court considered two issues: (1) whether certiorari had been properly granted and (2) whether prosecutors should present exculpatory evidence to grand juries. The Court first considered whether it properly granted certiorari, since the government (the petitioner) did not previously argue that *Page* was wrongly decided. Traditionally, a question not "pressed or passed upon below" is not reviewed by the Supreme Court.[50] This rule ensures the development of the factual record and gives the Justices the full benefit of competing arguments.[51] Justice Scalia determined, however, that the Tenth Circuit had indeed "passed on" the prosecutor's obligation to tell the grand jury about exculpatory evidence in its decision in *United States v. Williams*.[52] Two previous cases established that an issue not pressed could be reviewed so long as it had been passed upon.[53] Justice Scalia then stated a new rule to permit the Supreme Court to review a question even though it was not contested below:

> It is a permissible exercise of our discretion to undertake review of an important issue expressly decided by a federal court where, although the petitioner did not contest the issue in the case immediately at hand, it did so as a party to the recent proceeding upon which the lower courts relied for their resolution of the issue, and did not concede in the current case the correctness of that precedent.[54]

The Court next considered the substantive issue: whether a district court may dismiss an otherwise valid indictment because the government failed to disclose substantial exculpatory evidence to the grand jury. Justice Scalia first considered whether the supervisory power of the federal courts extends to the grand jury. The federal courts possess the authority to establish procedural rules not specifically required by the Constitution or the Congress,[55] but Justice Scalia found that this

48. United States v. Williams, 112 S. Ct. 1735, 1742 (1992).
49. *See supra* notes 12-14 and accompanying text.
50. *Williams*, 112 S. Ct. at 1738.
51. David O. Stewart, *Advantage Government: Is It Easier for the Government to Win in the Supreme Court?*, 78 A.B.A. J. 46 (1992).
52. 112 S. Ct. at 1740 n.4; *See Williams*, 899 F.2d at 900.
53. Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749, 2761 (1991); Stevens v. Department of Treasury, 111 S. Ct. 1562, 1567 (1991).
54. *Williams*, 112 S. Ct. at 1740-41 (footnote omitted).
55. United States v. Hasting, 461 U.S. 499, 505 (1983).

authority applies only to the court's power to control its *own* procedures.[56] Even though *Bank of Nova Scotia* made it clear that this supervisory power could be used to dismiss an indictment because of misconduct before the grand jury,[57] this power only applies to misconduct that violates "clear rules . . . drafted . . . by this Court and by Congress."[58] Stressing the grand jury's "operational separateness" from the courts,[59] Scalia held that the supervisory power of the courts cannot be used to prescribe prosecutorial misconduct before a grand jury.[60]

Justice Scalia then considered whether Fifth Amendment "common law" justified the Tenth Circuit's ruling in order to preserve the effectiveness of the grand jury's constitutional role as an " 'independent and informed' " body.[61] He concluded that "requiring the prosecutor to present exculpatory . . . evidence would alter the grand jury's historical role, transforming it from an accusatory to an adjudicatory body."[62] For a balanced presentation to be made in this situation, the person under investigation should be the one to present such evidence, not the prosecutor; yet this conflicts with more than 200 years of grand jury practice.[63] Also, the grand jury itself can decide not to hear more evidence when it believes it has enough to bring an indictment, even though the prosecutor offers more. If the grand jury is not required to hear exculpatory evidence, the prosecutor should not be obliged to present it.[64] The Court concluded that a prosecutor has no duty to present exculpatory evidence to a grand jury, reversing the Tenth Circuit.

2. The Dissenting Opinion

Justice Stevens, writing for the dissent, sharply differed with both holdings of the majority. In arguing that certiorari should have been denied, Justice Stevens said that the Tenth Circuit did not "pass upon" *Page* in its opinion; it simply restated *Page* and applied it as settled law.[65] In addition, the government not only failed to challenge *Page* in the Tenth Circuit case, but actually urged the court to follow *Page*'s holding and find that the evidence was not exculpatory.[66] The government did not actually challenge *Page* until it petitioned the Supreme Court for certiorari. The majority's holding that the Supreme Court can grant certiorari in such circumstances, Justice Stevens concluded, may result in a significantly expanded caseload.[67] More important, it gives an unfair

56. *Williams*, 112 S. Ct. at 1741.
57. *Id.* (citing Bank of Nova Scotia v. United States, 487 U.S. 250 (1988)).
58. *Id.* (quoting United States v. Mechanik, 475 U.S. 66, 74 (1986)).
59. *Id.* at 1743.
60. *Id.* at 1742.
61. *Id.* at 1744 (quoting Wood v. Georgia, 370 U.S. 375, 390 (1962)).
62. *Id.*
63. *Id.* at 1744-45.
64. *Id.* at 1745.
65. *Id.* at 1747-48 (Stevens, J., dissenting).
66. *Id* at 1747.
67. *Id.* at 1748.

advantage to the United States because the United States is the most frequent litigant in federal courts. This advantage, warned Justice Stevens, will compromise the Court's duty to act impartially.[68]

Justice Stevens also objected to the majority's substantive holding. Unlike the majority, the dissent maintained that the courts have the power to supervise grand juries. The dissent found considerable support for the idea that the grand jury, although independent, is and has always been subject to the control of the Court.[69] The dissent also found previous recognition by the Supreme Court of its authority to create and enforce limited rules applicable to grand jury proceedings, even though the Court has declined exercise this authority.[70] The application of this supervisory power is necessary to curb prosecutorial misconduct, which is varied and not infrequent.[71] Justice Stevens considered this conduct intolerable because the prosecutor represents a sovereign that is obliged to govern impartially.[72] Justice Stevens advocated adopting the standard of the United States Department of Justice. This standard holds that "when a prosecutor conducting a grand jury inquiry is personally aware of substantial evidence which directly negates the guilt of a subject of an investigation, the prosecutor must present or otherwise disclose such evidence to the grand jury before seeking an indictment."[73]

### E. *Analysis and Conclusion*

The Supreme Court, in reversing the Tenth Circuit, extended its reluctance to question the validity of grand jury indictments. In effect, the language of the decision foreclosed any meaningful judicial supervision of the grand jury in any context, not just that of an incomplete presentation of evidence. By stressing the traditional independence of the grand jury from the courts,[74] and by affirming that the procedural rules formulated by courts apply only to the courts' own procedures,[75]

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68. *Id.* at 1748-49.

69. *See, e.g.*, United States v. Calandra, 414 U.S. 338, 346 n.4 (1974); Brown v. United States, 359 U.S. 41, 49 (1959), *overruled on separate point by* Harris v. United States, 382 U.S. 162, 167 (1965); Blair v. United States, 250 U.S. 273, 283 (1919); Falter v. United States, 23 F.2d 420, 426 (2d Cir.), *cert. denied*, 277 U.S. 590 (1928).

70. Bank of Nova Scotia v. United States, 487 U.S. 250, 256 (1988); *Calandra*, 414 U.S. at 343; Costello v. United States, 350 U.S. 359, 364 (1956).

71. *See, e.g.*, United States v. Samango, 607 F.2d 877, 884 (9th Cir. 1979) (prosecutor failing to inform grand jury of its authority to subpoena witnesses); United States v. Basurto, 497 F.2d 781, 786 (9th Cir. 1974) (prosecutor presenting perjured testimony); United States v. Lawson, 502 F. Supp. 158, 162 nn.6-7 (D. Md. 1980) (prosecutor misstating the facts on cross-examination of a witness); United States v. Roberts, 481 F. Supp. 1385, 1389 n.10 (C.D. Cal. 1980) (prosecutor misstating the law); United States v. Gold, 470 F. Supp. 1336, 1346-51 (N.D. Ill. 1979) (prosecutor operating under a conflict of interest); United States v. Phillips Petroleum, Co., 435 F. Supp. 610, 615-17 (N.D. Okla. 1977) (prosecutors failing to inform grand jury of exculpatory evidence obtained from a witness questioned outside the grand jury).

72. *Williams*, 112 S. Ct. at 1750 (Stevens, J., dissenting).

73. U.S. DEP'T OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL, tit. 9, ch. 11, ¶ 9-11.233 (1988) (amended 1990).

74. *Williams*, 112 S. Ct. at 1743.

75. *Id.* at 1741.

the Supreme Court cut the grand jury loose from any hobbles applied by the lower courts. A grand jury indictment may be dismissed only when the prosecutor violates a constitutional or statutory restriction.[76] At bottom, the Court fears that greater supervision[77] will lead to collateral proceedings and disruptive delaying tactics by the defense, consuming "valuable judicial time"[78] and "run[ning] counter to the whole history of the grand jury institution."[79] The grand jury, moving far from its traditional role as an accusatory body, will become an adjudicatory force. Criminal investigations will be impeded.[80]

As a practical matter, prosecutors will find it even easier to convince the grand jury to indict. Defendants, having lost the protection given by *Page* and similar decisions,[81] can depend only on other rules that may influence prosecutors, such as the rule of the Department of Justice that requires United States attorneys to disclose substantial exculpatory evidence to the grand jury or face reprimands.[82] Justice Scalia accepted the government's argument that such rules would indeed act to curb overzealous prosecutors.[83] It remains to be seen whether Congress will agree with the Court's decision, or find it necessary to enact statutory restrictions governing prosecutors' failure to present exculpatory evidence to grand juries.[84]

## II. *UNITED STATES V. FELIX*: ADMISSION OF EVIDENCE OF A CRIME IS NOT THE SAME AS PROSECUTION OF THAT CRIME AND DOES NOT ESTABLISH A DOUBLE JEOPARDY VIOLATION; SUBSTANTIVE CRIME AND CONSPIRACY TO COMMIT THAT CRIME ARE NOT THE SAME OFFENSE FOR DOUBLE JEOPARDY PURPOSES

### A. *Introduction*

The Fifth Amendment states in part: "No person shall . . . be subject for the same offence to be twice put in jeopardy of life or limb . . . ."[85] It is unfortunate that a concept so basic[86] and with so long a history[87] should have become such a quagmire in modern jurispru-

76. *Id. See also* Steven A. Shaw, *It's 'No Holds Barred' in the Grand Jury Room*, TEX. LAW., July 13, 1992, at 10.

77. *See* Poulin, *supra* note 8; Currier, *supra* note 5.

78. *Williams*, 112 S. Ct. at 1746.

79. *Id.* at 1744.

80. *See* Arenella, *supra* note 11, at 566-67 (discussing the ramifications of requiring prosecutors to present exculpatory evidence).

81. *See supra* notes 28-29 and accompanying text.

82. *See supra* note 73 and accompanying text.

83. *See Justices Hear Debate on Government Duty to Give Grand Jury Exculpatory Evidence*, 60 U.S.L.W. 1128 (1992) (summarizing the government's argument before the Supreme Court).

84. For a discussion on this point, see Stuart Taylor, Jr., *End the Grand Jury Charade*, AM. LAW., June 1992, at 32.

85. U.S. CONST. amend. V. The Fourteenth Amendment incorporates the double jeopardy clause; thus, its prohibitions apply to state prosecutions. Benton v. Maryland, 395 U.S. 784, 794 (1969).

86. Eli J. Richardson, *Matching Tests for Double Jeopardy Violations with Constitutional Interests*, 45 VAND. L. REV. 273, 274 (1992).

87. *See* Whalen v. United States, 445 U.S. 684, 699 (1980) (Rehnquist, J., dissenting)

dence.[88] The sticking point is the phrase "same offence." Courts in literally thousands of decisions[89] have struggled to define this phrase. The Supreme Court has struggled in the same way and to much the same result. *United States v. Felix*[90] represents the Court's most recent attempt to clarify a very small piece of this very large fogbank.

The basic functions of the double jeopardy clause are at least clear. Double jeopardy protects defendants in four ways: (1) it provides finality; (2) it prevents prosecutorial harassment; (3) it preserves the jury's prerogatives to resolve factual issues; and (4) it bars successive prosecutions (resulting from several proceedings) and multiple punishments (resulting from one proceeding).[91] Discussions of "same offense" sprang from the constitutional bar against successive prosecutions and multiple punishments. *Blockburger v. United States*[92] enunciated the first test of whether double jeopardy exists in the context of multiple punishments. This test, however, was later seen to be insufficient for the analysis of successive prosecutions.[93] Two recent cases, *Dowling v. United States*[94] and *Grady v. Corbin*,[95] attempted to clarify the steps to be taken in analyzing this problem by adopting conduct-based standards. *Grady*, however, marked a break from the Court's earlier double jeopardy jurisprudence[96] and cannot be reconciled with the *Dowling* decision, because evidence ruled admissible in *Dowling* would be barred by *Grady*.[97] Also, the lower courts have applied the *Grady* standard inconsistently,[98] or have failed to apply it in the manner the Supreme Court envisioned.[99]

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(explaining that the guarantee against double jeopardy dates back to the days of Demosthenes, who stated that "the laws forbid the same man to be tried twice on the same issue") (quoting 1 Demosthenes 589 (J. Vance trans., 4th ed. 1970)). *See generally* George C. Thomas III, *The Prohibition of Successive Prosecutions for the Same Offense: In Search of a Definition*, 71 IOWA L. REV. 323, 325 (1986) (noting that the law of double jeopardy dates back to ancient Greek, Hebrew and Roman law).

88. Justice Rehnquist has described law in the double jeopardy area as "a veritable Sargasso Sea which could not fail to challenge the most intrepid judicial navigator," Albernaz v. United States, 450 U.S. 333, 343 (1981), and as a "Gordian knot," *Whalen*, 445 U.S. at 702 (Rehnquist, J., dissenting).

89. Thomas, *supra* note 87, at 330.

90. 112 S. Ct. 1377 (1992) [*Felix II*].

91. Tat Man J. So, *Double Jeopardy, Complex Crimes and* Grady v. Corbin, 60 FORDHAM L. REV. 351, 352 (1991).

92. 284 U.S. 299 (1932). *Blockburger* established the standard that where the same act may violate two different statutes, the two statutory offenses are not the same if each requires proof of a fact that the other does not. *Id.* at 304.

93. Grady v. Corbin, 110 S. Ct. 2084, 2092 (1990).

94. 493 U.S. 342 (1990) (admission of testimony from a previous prosecution in which defendant was acquitted does not violate the collateral-estoppel component of the double jeopardy clause).

95. 110 S. Ct. 2084 (1990). "[T]he Double Jeopardy Clause bars a subsequent prosecution if, to establish an essential element of an offense charged in that prosecution, the Government will prove conduct that constitutes an offense for which the defendant has already been prosecuted." *Id.* at 2087.

96. *Id.* at 2101 (Scalia, J., dissenting).

97. *Id.* at 2095-96 (O'Connor, J., dissenting).

98. United States v. Felix, 112 S. Ct. 1377, 1381 n.2 (1992) [*Felix II*].

99. *Id.* at 1382 ("we think that this is an extravagant reading of *Grady*"); *id.* at 1384 ("we decline to read the language so expansively . . . because of difficulties which have already arisen in [*Grady*'s] interpretation.").

For instance, the Second and Tenth Circuits bar conspiracy prosecutions if the defendant has already been prosecuted for the substantive offenses supporting the conspiracy charge, while the First and Fourth Circuits allow such prosecutions.[100] The Court used *Felix* both to clarify the meaning of *Grady* and to reconcile it with *Dowling*.

B. *Facts*

Sometime in the spring of 1987, a meeting between Frank Dennis Felix and unindicted co-conspirator Paul Roach resulted in an agreement that Felix would supply Roach with financing, chemicals and equipment in exchange for Roach's instructions on how to manufacture ("cook") methamphetamine.[101] Felix then bought the chemicals and equipment needed from George Dwinnells, a United States Drug Enforcement Administration (DEA) confidential informant, who sold chemicals and equipment to Felix on a number of occasions.[102] Felix told Dwinnells he was trying to make "dope."[103] In May 1987, Roach and Felix set up a methamphetamine laboratory in a trailer parked on an oil lease near Beggs, Oklahoma, in which they manufactured methamphetamine four to six times[104] from June 1 to July 13, 1987.[105] Felix paid Roach $4000 for Roach's part of the laboratory work.

On July 13, 1987, DEA officials seized the unattended Beggs trailer while a "cook" was in progress.[106] They seized methamphetamine oil, illegal precursor chemicals, manufacturing equipment and other evidence, some of which inculpated Felix.[107] Felix himself escaped capture in a time-honored way—he hid in the woods.[108]

Shortly thereafter, Felix telephoned Dwinnells and arranged a meeting at a Tulsa, Oklahoma, bar.[109] At this meeting on August 26, 1987, Felix gave Dwinnells a matchbook cover with a list of chemicals and equipment for making methamphetamine. Felix also gave Dwin-

100. The Second Circuit barred conspiracy prosecutions when the defendant had previously been prosecuted for a conspiracy where the actions entirely encompassed the actions of the second conspiracy. United States v. Calderone, 917 F.2d 717 (2d Cir. 1990). Later, the Second Circuit held that a conspiracy prosecution is barred if overt acts supporting the conspiracy charge involve substantive offenses for which the defendant has already been prosecuted. United States v. Gambino, 920 F.2d 1108 (2d Cir. 1990), *cert. denied*, 112 S. Ct. 54 (1992). The Tenth Circuit followed the *Gambino* reasoning in its decision in *Felix II*, 926 F.2d 1522 (1991).

In contrast, the First Circuit and the Fourth Circuit have come to the opposite conclusion, that subsequent conspiracy prosecutions are not barred. United States v. Rivera-Feliciano, 930 F.2d 951 (1st Cir. 1991), *cert. denied*, 112 S. Ct. 1676 (1992); United States v. Clark, 928 F.2d 639 (4th Cir. 1991).

101. United States v. Felix, 926 F.2d 1522, 1524 (10th Cir. 1991), *rev'd*, 112 S. Ct. 1377 (1992) [*Felix II*]. Roach later became a government witness at Felix's trial.

102. United States v. Felix, 867 F.2d 1068, 1070 (8th Cir. 1989) [*Felix I*].

103. *Id.*

104. *Id.*

105. *Felix II*, 926 F.2d at 1524 n.1.

106. *Id.* at 1524.

107. *Id.* A car owned by Felix was seized at the laboratory. *Felix I*, 867 F.2d at 1070 n.3.

108. *Felix I*, 867 F.2d at 1070.

109. *Felix II*, 926 F.2d at 1524.

nells a down payment of $7500, told him to get a trailer to transport the items and gave him directions and a phone number so the items could be delivered.[110] DEA agents observed this meeting.[111] In a later telephone conversation, Felix told Dwinnells to deliver the items to the Joplin, Missouri, Holiday Inn; Dwinnells informed the DEA of this arrangement.[112]

The DEA arranged a controlled delivery to be made by Dwinnells in Joplin on August 31, 1987, with DEA agents and the Missouri Highway Patrol providing surveillance. Dwinnells drove his vehicle from Tulsa to Joplin with the trailer attached. Felix met Dwinnells at the Joplin Holiday Inn, where Felix, after checking the trailer's contents, attached new locks to its rear doors and hitched it to his car. The DEA arrested Felix shortly thereafter.[113]

### C. *The Federal District Court Decisions*

#### 1. The Missouri District Court

On September 15, 1987, a federal grand jury indicted Felix in Missouri and charged him with one count of attempting to manufacture methamphetamine between August 26 and 31, 1987,[114] in violation of the Controlled Substances Act.[115] Felix's defense was that he never had criminal intent, but believed that he was working in a covert operation for the DEA.[116] To support its case that Felix had the requisite intent, the government introduced the evidence of Felix's earlier activities in Oklahoma[117] under Federal Rule of Evidence 404(b).[118] In his instructions to the jury, District Judge Russell G. Clark carefully cautioned the jury that this evidence should be considered only to determine Felix's state of mind with respect to his Missouri activities, not to determine his guilt with respect to that evidence.[119] The judge's instructions were in accordance with the Eighth Circuit's relevant pattern instruction.[120]

110. *Felix I*, 867 F.2d at 1070.

111. *Felix II*, 926 F.2d at 1524.

112. *Id.* at 1525.

113. *Felix I*, 867 F.2d at 1070-71. Felix did not tell the arresting officers at this time that he was working as a covert operator for the DEA, even though he used this as a defense at trial. *Id.* at 1071.

114. *Id.*

115. 21 U.S.C. § 841(a)(1) (1988) and Pub. L. No. 91-513, 84 Stat. 1265 (1970) (current version at 21 U.S.C. § 846 (1988)). Section 841(a) provides: "Except as authorized by this subchapter, it shall be unlawful for any person knowingly or intentionally" (1) to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense, a controlled substance . . . ."

Section 846, since amended, provided: "Any person who attempts or conspires to commit any offense defined in this subchapter is punishable by imprisonment or fine or both which may not exceed the maximum punishment prescribed for the offense, the commission of which was the object of the attempt or conspiracy."

116. *Felix I*, 867 F.2d at 1074.

117. *See supra* notes 101-07 and accompanying text.

118. "Evidence of prior acts is admissible to show 'motive, opportunity, intent, preparation, plan, knowledge, identity, or absence of mistake or accident.' " *Felix II*, 112 S. Ct. at 1380 (quoting FED. R. EVID. 404(b)).

119. *Felix I*, 867 F.2d at 1075.

120. *Id.*

The jury convicted Felix, and he was fined and sentenced to seven years in prison.[121] The Eighth Circuit Court of Appeals affirmed the conviction.[122]

2. The Oklahoma District Court

On February 16, 1989, the government charged Felix in Oklahoma with violations of the Controlled Substances Act and named him in eight counts of an eleven-count indictment.[123] Count 1 charged Felix and others with conspiring from about May 1, 1987, to August 31, 1987, to manufacture methamphetamine. Two of the overt acts supporting this charge were based on conduct that was the subject of the Missouri prosecution.[124] Counts 2 through 6 charged Felix with substantive crimes (manufacturing methamphetamine and phenylacetone, possession of methamphetamine with intent to distribute and maintaining a place for manufacturing methamphetamine), and Counts 9 and 10 charged Felix with interstate travel with intent to promote the manufacture of methamphetamine.[125]

Before the April, 1989, trial, Felix moved to dismiss the indictment on double jeopardy grounds.[126] The trial court denied this motion. Felix was then convicted on all counts after a jury trial.[127]

D. *The Tenth Circuit Decision*

1. The Majority Opinion

On appeal to the Tenth Circuit, Felix raised only one issue: that the Oklahoma district court trial subjected him to double jeopardy because the evidence introduced at the Oklahoma trial was identical to that used to prosecute him in the Missouri trial. The Tenth Circuit, in an opinion written by William J. Holloway, Jr., Chief Judge, agreed, affirming in part and reversing in part.[128]

The Tenth Circuit began by determining that *Grady v. Corbin* applied in this situation.[129] *Grady* held that "the Double Jeopardy Clause bars any subsequent prosecution in which the government, to establish an essential element of an offense charged in that prosecution, will prove conduct that constitutes an offense for which the defendant has already

121. *Id.* at 1070.
122. *Id.*
123. *Felix II*, 926 F.2d at 1524 (10th Cir. 1991). See *supra* note 115 for the text of the Controlled Substances Act.
124. Overt act 17 charged that "[o]n August 26, 1987, Frank Dennis Felix, while in Tulsa, Oklahoma, provided money for the purchase of chemicals and equipment necessary in the manufacture of methamphetamine." Overt act 18 charged that "[o]n August 31, 1987, Frank Dennis Felix, while at a location in Missouri, possessed chemicals and equipment necessary in the manufacture of methamphetamine." *Felix II*, 112 S. Ct. at 1380.
125. *Felix II*, 926 F.2d at 1524 n.1.
126. *Id.* at 1525.
127. *Id.* at 1524.
128. *Id.* at 1531.
129. *Id.* at 1528.

been prosecuted."[130] In a *Grady* analysis, the focus is on the defendant's conduct, not on the evidence the government uses to prove that conduct. The Tenth Circuit, applying this standard to the counts listed in the Oklahoma district court indictment,[131] found that for Counts 1 through 6, the duplication of the conduct proved in the Missouri trial and the Oklahoma trial was extensive; thus, the counts could not stand.[132] The Tenth Circuit's opinion actually expanded the protections given by *Grady* by holding that presenting evidence at one trial bars a subsequent prosecution on other charges using the same evidence.

2. The Dissenting Opinion

Tenth Circuit Judge Stephen H. Anderson wrote a vigorous dissent. The majority, he wrote, expanded *Grady* far beyond the interpretation intended by the Supreme Court, even "dangerously" beyond.[133] The dissent claimed that the majority ignored the plain meaning of *Grady*. The majority interpreted *Grady* to establish a "same conduct" test. But in *Grady*, the dissent pointed out, "conduct" meant only that conduct "that constitutes an offense for which the defendant has already been prosecuted."[134] The majority failed to analyze Felix's conduct in this way. In addition, the majority confused "conduct" with "evidence." Although the majority said it was applying a same conduct test, it proceeded to analyze, not the *conduct* proved, but the *evidence* presented at each trial. *Grady* explicitly made a distinction between previously prosecuted conduct and evidence used to prove that conduct.[135]

The dissent also warned that the majority's interpretation "eviscerates" Federal Rule of Evidence 404(b) because, by the majority's analysis, introduction of Rule 404(b) prior bad act evidence to prove intent is the same as prosecution for that bad act. Thus, Rule 404(b) evidence could never be used when the defendant had already been prosecuted for that bad act, nor could this evidence, once used, be used in the same way in another trial.[136] The Supreme Court never intended that *Grady* should be interpreted in this way.[137]

E. *The Supreme Court Decision*

The Supreme Court moved decisively in a unanimous decision to

130. Grady v. Corbin, 495 U.S. 508, 521 (1990).

131. *See supra* notes 124-25 and accompanying text.

132. *Felix II*, 926 F.2d at 1529-31. Counts 9 and 10, charging interstate travel to promote the manufacture of methamphetamine, did not prove the same conduct as the Missouri trial, and Felix's convictions of these counts were affirmed. *Id.* at 1531.

133. *Id.* at 1532 (Anderson, J., dissenting).

134. *Id.*

135. *Id.* at 1533 (citing *Grady*, 495 U.S. at 521).

136. *Id.* at 1534.

137. In fact, the Supreme Court specifically said in *Grady* that "the presentation of specific evidence in one trial does not forever prevent the government from introducing that same evidence in a subsequent proceeding." *Id.* at 1534 n.5 (quoting *Grady*, 495 U.S. at 521-22 (1990)).

quash the Tenth Circuit's expansion of the *Grady* test[138] and to clear up a difference in the circuits on the application of *Grady* to conspiracy prosecutions.[139] The Court, in an opinion written by Chief Justice Rehnquist, first considered whether the Tenth Circuit had erred in overturning Felix's convictions on substantive Counts 2 through 6[140] on the basis that he was prosecuted for the same conduct in both the Missouri trial and the Oklahoma trial. The Court determined that there was no common conduct linking the crimes for which Felix was prosecuted in Oklahoma and Missouri.[141] Even though evidence of the Oklahoma conduct was introduced at the Missouri trial, Felix was never prosecuted in Missouri for any crimes other than those he committed in Missouri. The Tenth Circuit was mistaken in making the assumption that offering evidence of one crime in a trial for another crime barred a subsequent prosecution for the former crime.[142] *Dowling v. United States*[143] implied that the introduction of evidence of misconduct is not the same as prosecution for that misconduct, and *Grady v. Corbin* endorsed this principle.[144] The Court specifically declined to accept a rule that admission of evidence under Rule 404(b) constituted prosecution of that crime[145] and stated that such an interpretation of *Grady* was "extravagant."[146]

The Court then considered whether the Double Jeopardy clause barred Count 1 of the Oklahoma indictment, the conspiracy charge. The various circuits interpreted *Grady* differently with respect to conspiracy charges,[147] and Rehnquist conceded that the *Grady* language[148] cast some doubt on Felix's conspiracy conviction when taken out of context and read literally.[149] But previous decisions of the Supreme Court are at odds with *Grady* and its interpretation that conspiracy prosecutions are barred by the Double Jeopardy clause. These decisions determined that a conspiracy to commit an offense and the offense itself are distinct and that, for double jeopardy purposes, the offenses are separate.[150] The *Felix* Court chose to follow this established line of cases rather than use *Grady* to determine whether double jeopardy applies. Thus, *Felix* establishes that the Double Jeopardy clause does not bar prosecution of a conspiracy when the defendant has already been convicted of the substantive crimes that resulted from the conspiracy.

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138. *Felix II*, 112 S. Ct. at 1381.
139. *See id.* at 1381 n.2.
140. *See supra* notes 124-25 and accompanying text.
141. *Felix II*, 112 S. Ct. at 1382.
142. *Id.*
143. 493 U.S. 342 (1990).
144. *See supra* note 137 and accompanying text.
145. *Felix II*, 112 S. Ct. at 1383 n.3.
146. *Id.* at 1382.
147. *See supra* note 100.
148. *See supra* text accompanying note 130.
149. *Felix II*, 112 S. Ct. at 1383.
150. *E.g.*, United States v. Bayer, 331 U.S. 532, 542 (1947) ("the agreement to do the act is distinct from the act itself"); Pinkerton v. United States, 328 U.S. 640, 643 (1946) (a "substantive offense and a conspiracy to commit it are separate and distinct offenses . . . [a]nd the plea of double jeopardy is no defense").

F. *Analysis and Conclusion*

In reversing the Tenth Circuit, the Supreme Court firmly put to rest any attempts to expand *Grady* beyond its facts and established a small bit of solid ground in the murky world of double jeopardy analysis. The Court closely followed Judge Anderson's analysis in the Tenth Circuit dissenting opinion.[151] The Court preserved the use of Federal Rule of Evidence 404(b)[152] by holding that overlapping proof does not establish a double jeopardy violation.[153] The Court's holding resolved conflicting circuit decisions on the use of *Grady* in conspiracy prosecutions and affirmed that conspiracy is not the same offense as the substantive crime for double jeopardy purposes. *Felix* shows that the Court intended that *Grady* should be narrowly interpreted; *Grady* does not hold that offering evidence of misconduct in one prosecution bars a subsequent prosecution for that misconduct. The *Felix* decision put an end to the idea that *Grady* requires a same evidence test. However, *Felix* does nothing to define the scope of the same conduct test that it affirms. Double jeopardy analysis remains "enmeshed in . . . subtleties."[154]

## CONCLUSION

*Williams* confirmed the reluctance of the Supreme Court to supervise the activities of grand juries, and made it clear that prosecutors must fear only the threat of reprimands and sanctions by administrative agencies, absent some action by Congress to prescribe limitations on their behavior. *Felix*, by affirming a narrow interpretation of *Grady*, made the prosecutor's task easier. *Felix* allows a more generous interpretation of what evidence is admissible without jeopardizing subsequent prosecutions and ensures the separation of conspiracies and the substantive crimes attached to them. Both decisions support the opinion that the Court is joining in the efforts of other governmental powers in the war on crime[155] by eroding constitutional protections relied on by potential

151. *Felix II*, 926 F.2d at 1532 (Anderson, J., dissenting).

152. *See id.* at 1534 (stating that rule 404(b) will be "eviscerated" because the Tenth Circuit's decision holds that introduction of prior bad act evidence to prove intent is the same as prosecution for that bad act); Grady v. Corbin, 495 U.S. 508, 526 (O'Connor, J., dissenting) (the Court's decision "casts doubt on the continued vitality of Rule 404(b)"); Richardson, *supra* note 86, at 303-05 (if the Court chooses to interpret *Grady* narrowly, rule 404(b) will not be diluted).

153. *Felix II*, 112 S. Ct. at 1382.

154. *Id.* at 1385. *See, e.g.*, Richardson, *supra* note 86; Thomas, *supra* note 87; So, *supra* note 91, at 370-71. *But see* James M. Herrick, Note, *Double Jeopardy Analysis Comes Home: The "Same Conduct" Standard in* Grady v. Corbin, 79 KY. L.J. 847, 866 (1990-91) ("[*Grady*] alleviate[s] the confusion in [this] doctrinal area . . . .").

155. *See, e.g.*, Organized Crime Control Act, Pub. L. No. 91-452, 84 Stat. 922, 923 (1970) (codified as amended in scattered sections of 18 U.S.C.):

> It is the purpose of this Act to seek the eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime.

defendants.[156]

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156. For instance, the narrow interpretation of *Grady* supported by the *Felix* decision will prevent *Grady* from being applied in a RICO context. For a discussion of *Grady's* effect on RICO criminal prosecutions, see Ramona L. McGee, *Criminal RICO and Double Jeopardy Analysis in the Wake of* Grady v. Corbin: *Is This RICO's Achilles Heel?*, 77 CORNELL L. REV. 687 (1992).